Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	)	WC Docket No. 02-112
	)	
	)	
	)	
2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules	)	CC Docket No. 00-175
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COMMENTS OF AT&T CORP.

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COMMENTS OF AT&T CORP.

AT&T Corp. ("AT&T") respectfully submits these comments in response to the Commission's Further Notice of Proposed Rulemaking in the above-captioned proceeding.[1]

SUMMARY AND INTRODUCTION.

The issue before the Commission is whether the Bell Operating Companies ("BOCs") must be regulated as dominant carriers when providing in-region long distance services on an integrated basis. The answer is straightforward. Because the BOCs control bottleneck facilities that they can use to raise long distance rivals' costs and thereby restrict total output, settled Commission precedent and basic economics compel dominant carrier classification.

Commission rules require dominant carrier regulation of all carriers with market power. In the *LEC Classification Order*,[2] the Commission found that the BOCs plainly control

[1] FCC 03-111 (rel. May 19, 2003) ("Notice").

bottleneck inputs -- the last mile network of loops, switches and trunks that are necessary to originate and terminate long distance calls. And consistent with longstanding precedent and indisputable economic principles, the Commission concluded that because of this fact, the BOCs possess market power.

Nonetheless, the Commission declined to declare the BOCs' long distance *affiliates* dominant, finding that three factors prevented the BOCs' from exercising their market power on behalf of their affiliates. First, the Commission relied on the fact that the BOCs' affiliates were required by section 272 to be "structurally separate" from the BOCs and to "operate independently" from the BOCs.[3] Second, the Commission relied on rate regulation that it predicted would further constrain the BOCs' incentives and ability to exercise their market power on behalf of their separate affiliates.[4] Finally, the Commission relied on the fact that the BOCs' section 272 affiliates would be entering long distance markets with "zero" market shares to support a prediction that any attempt by a BOC to dominate long distance markets by cost/price squeezing rivals would fail.[5]

This same analytical framework now compels the classification of the BOCs themselves as dominant providers of long distance services. It is indisputable that the BOCs still

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[2] Second Report and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* 12 FCC Rcd. 15756, ¶¶ 83, 158-61 (1997) ("*LEC Classification Order*"), unrelated provisions modified, Order on Reconsideration, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* 12 FCC Rcd. 8730 (1997).

[3] *Id.* ¶ 91, 112-18.

[4] *Id.* ¶ 91, 126-30. Indeed, the Commission opined that it believed that the risks of price squeezes going forward would be less because of its (unfulfilled) intent to push access prices towards costs. *See id.* ¶ 130.

[5] *Id.* ¶ 91.

retain bottleneck facilities that are essential for long distance competition. There is overwhelming evidence that incumbent market power over the local bottleneck is not significantly reduced even years after a BOC receives section 271 relief. Commission precedents make clear that such bottleneck control confers market power in all downstream markets, including all interstate and intrastate, interLATA and intraLATA retail long distance services provided within ILEC service areas. Thus, as the Commission found in the *LEC Classification Order*, absent regulation designed to prevent and detect bottleneck abuses, the BOCs could and would use those facilities to raise rivals' costs and thereby reduce competition.

At the same time, the regulation and other factors that the Commission cited in 1997 as constraining abuses of that power on behalf of a structually separate long distance affiliate place no such constraints on the BOCs themselves under the changed circumstances relevant here and, in any event, have now been demonstrated to be based upon fundamentally flawed predictive judgements. As the Notice underscores (¶ 5), the Commission's 1997 decision that BOC interLATA affiliates should be treated as nondominant "was predicated on the presence of a section 272 separate affiliate and full compliance with the structural, transactional, and nondiscrimination safeguards of section 272 and the Commission's implementing rules."

However, the Commission has signaled that it will allow the "crucially important"[6] section 272 safeguards designed to prevent and detect discrimination and cost misallocation to sunset. Thus, the BOCs soon will have (and in the case of Verizon in New York, already have) no obligation to maintain a "structurally" separate affiliate that must "operate independently" from the BOCs' incumbent operations and will be able to provide long

[6] Memorandum Opinion and Order, *Application of SBC Communications to Provide In-Region, InterLATA Services in Texas,* 15 FCC Rcd. 18354, ¶ 395 (2000).

distance on an integrated basis.[7] Indeed, this proceeding addresses "the continued need for dominant carrier regulation of BOC in-region, interstate and international interexchange telecommunications services *after sunset of the Commission's section 272 structural and related requirements in a state*." Notice, ¶ 2 (emphasis added).

Likewise, since the *LEC Classification Order*, the Commission has largely deregulated the BOCs' prices for special access services. Rather than use this new-found "pricing flexibility" to meet competition, the BOCs have almost uniformly used it to *raise* rates. As a result, the spread between the BOCs' cost of providing access and the rates that they charge IXCs for access have increased, heightening the ability of the BOCs to price-cost squeeze their rivals. Moreover, despite the Commission's belief that switched access rates would be decreased signficantly in the future, "switched" access charges, particularly intrastate switched access charges, remain orders of magnitude above cost. The BOCs' ability to price squeeze has also increased since 1997 as a result of consolidation in the industry. The Ameritech-Pacific Telesis-SBC-SNET and Bell Atlantic-GTE-NYNEX mergers have made it much more likely that a call that originates on a particular BOC's network will terminate on that same BOC's network, thereby giving the BOC an insurmountable cost advantage with regard to *both* originating and terminating access.[8]

Lastly, entering long distance markets with a zero share has proven to be no disadvantage to the BOCs at all. In the short time since entering, the BOCs separate long

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[7] *See* 47 U.S.C. § 272(b).

[8] *See* Memorandum Opinion and Order, *In re Applications of Ameritech, Transferor and SBC, Transferee,* 14 FCC Rcd. 14712, ¶ 207, ("*SBC-Ameritech Merger Order")* (finding merger increased incentive of SBC-Ameritech to discriminate against competitors); *LEC Classification Order* ¶ 129 (relying on the fact that in 1997 that many long distance calls that originated on one (continued . . .)

distance affiliates have gained market share at an unprecedented rate. Indeed, in the less than three years since it was granted authority for its Southwestern territories, SBC's separate affiliate has already achieved "near 50 percent" penetration.[9]

The D.C. Circuit has made clear that where the Commission has based its existing regulatory regime on a predictive judgment, it is absolutely imperative that "the Commission . . . vigilantly monitor the consequences of its rate regulation rules."[10] That is particularly true when the Commission has based its original decision making on the existence of other regulation that it has subsequently permitted to lapse. Here, *none* of the bases upon which the Commission predicted that the BOCs' structurally separate affiliates would be unable to exercise market power in long distance services remains valid as applied to the BOCs themselves, and the Commission therefore must now recognize that there are no meaningful constraints on the ability of the BOCs to wield their bottleneck facilities to harm long distance competition.

Consequently, dominant carrier regulation is necessary to deter and detect such anticompetitive conduct -- and is required by core requirements of Title II and by U.S. international trade commitments to maintain "[a]ppropriate measures" to prevent "anticompetitive practices" by dominant carriers -- until the Commission carries out other essential reforms to prevent BOC abuse of their local bottlenecks. As the Commission has recognized, dominant carrier tariff filing and cost support requirements help prevent price squeezes and other anticompetitive conduct. Without section 272 safeguards, and with the

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BOC's network terminated on another BOC's network as diminishing the likelihood of a price squeeze).

[9] *See* Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings.

[10] *American Civil Liberties Union* v. *FCC,* 823 F.2d 1554, 1565 (D.C. Cir. 1987).

BOCs' heightened ability to engage in anticompetitive abuse of the local bottleneck when the same entity provides local and long distance services, the failure of the Commission to regulate the BOCs as dominant carriers would have predictable -- and devastating -- consequences for long distance competition. The BOCs "would ineluctably leverage that bottleneck control in the interexchange (long distance) market" and harm long distance competition.[11]

First, the BOCs can provide IXCs with access of much lower quality than they provide to their own long distance operations. As the Commission has recognized, there are myriad ways in which this can be accomplished, ranging from slow provisioning of access facilities to competitors to failure to maintain or repair facilities provided to competitors.[12] Second, because access charges are well-above costs, the BOCs' can price squeeze their competitors.

These are not theoretical concerns. As shown below and in the attached Declaration of Dr. Lee Selwyn ("Selwyn Dec."), there is ample evidence that BOCs already are using their above-cost switched and special access rates to price squeeze their competitors and are engaging in a variety of other anticompetitive activities to misallocate costs and discriminate against their long distance rivals. Because of the well-recognized difficulty in detecting such misconduct when local and long distance services are provided on an integrated basis, AT&T has urged the Commission not to allow any sunset of the section 272 safeguards that Congress

[11] *United States* v. *Western Electric Co.*, 969 F.2d 1231, 1238 (D.C. Cir. 1992).

[12] *SBC-Ameritech Merger Order* ¶ 206; *LEC Classification Order* ¶ 111. *See also* First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934,* 11 FCC Rcd. 21905, ¶ 163, (1996) ("*Non-Accounting Safeguards Order")* ¶ 163 (allowing the BOCs to provide long distance and local service on an integrated basis "would inevitably afford access to the BOC's facilities that is superior to that grant to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation.")

established for that very reason. To provide essential safeguards after any section 272 sunset, the BOCs should be required to comply with the dominant carrier rules until the Commission completes reforms removing the BOC access cost advantage and limiting their ability to engage in price and non-price discrimination.

That is not to say that the Commission must maintain dominant carrier classification on the BOCs forever. As explained below, the Commission could lift dominant carrier status once the BOCs' ability to leverage their bottlenecks is effectively constrained. This recommended approach would fulfill the objectives stated by the Notice (¶ 40) of "minimiz[ing] regulatory burden on the BOCs" while also "avoid[ing] the potential exposure of both ratepayers in local markets and competitors in interexchange markets to the potential risk of improper cost misallocation and unlawful discrimination."

Dominant carrier regulation will remain necessary until the Commission completes all of the following reforms to prevent incumbent leverage of the local bottleneck. First, the only effective means of preventing the BOCs from undertaking a price squeeze is to remove their ability to charge rivals above-cost rates for access. The Commission must undertake comprehensive intercarrier compensation reform to remove the BOC access cost advantage provided by the current system of interstate and intrastate access rates -- which also require IXCs to subsidize their BOC long distance competitors -- and establish meaningful regulatory constraints on BOC special access rates. Second, in order to prevent non-price discrimination, the Commission should adopt strong performance measures, supported by meaningful penalties for non-compliance. Third, the Commission should require an independent "PIC" administrator to stop ongoing abuses of the PIC process, and impose limits on BOC joint

marketing in order to prevent the BOCs from using their dominant position to steer discriminatorily customers to the BOCs' long distance affiliates.

While these reforms would not provide all the safeguards of section 272 or dominant carrier regulation, they would provide a basis to revisit the dominant status of BOC interLATA services by diminishing the BOCs' ability to leverage the local bottleneck. However, any grant of any nondominant treatment of those services before these necessary reforms are fully implemented would be highly premature and would merely encourage BOC anticompetitive abuse that would inevitably lead to the remonopolization of the U.S. long distance industry. As described by Dr. Selwyn, "[a]bsent the kind of affirmative regulatory oversight that is only possible where the BOCs are treated as dominant carriers, they will be able to crush their non-integrated rivals."[13]

The separation requirements currently applicable to the incumbent independent LECs are not subject to any sunset provision and, accordingly, may continue to provide a basis for nondominant treatment of these carriers' long distance services.

I. THE ILECS REMAIN DOMINANT CARRIERS BECAUSE OF THE OVERWHELMING MARKET POWER CONFERRED BY THEIR CONTINUING CONTROL OF THE LOCAL BOTTLENECK.

Under the Commission's rules, dominant carrier regulation is required for any carrier that can exercise market power in a relevant market.[14] As the Commission recognized in

[13] Selwyn Dec., ¶ 103.

[14] 47 C.F.R. §§ 61.3(q), 61.31. Market power is the "power to control prices," *id*., § 61.3(q), meaning "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable." Fourth Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services & Facilities Authorizations Therefor*, 95 FCC 2d 554, ¶ 8 (1983). *See also*, Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 57 Fed. Reg. 41552 (1992) reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13104 (April 2, 1992) §0.1 ("*1992 Merger Guidelines*") ("Market (continued . . .)

the *LEC Classification Order*, an entity that controls bottleneck facilities that are key inputs into a finished service plainly has the ability to exercise market power over that downstream service. "A carrier may be able to unilaterally raise prices by increasing its rivals' costs or by restricting its rivals' output through the carrier's control of an essential input, such as access to bottleneck facilities, which its rivals need to offer their services."[15] For that reason, analysis of whether control of bottleneck inputs could be used to impede competition in downstream markets has always played a central role in the Commission's dominance/nondominance determinations.[16]

The *LEC Classification Order* found that "the BOCs currently possess market power in the provision of local exchange and exchange access in their respective regions" and that the incumbent independent LECs ("independent LECs") similarly have "control over local bottleneck facilities."[17] There has been no significant diminution in their market power since then. Seven years after passage of the Telecom Act, the ILECs still provide 87 percent of the exchange and exchange access services, and their local loops, switches, and transport facilities are essential inputs in all but a small fraction of the exchange services that are now offered by

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power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time").

[15] Notice ¶ 5 n.10 (citing *LEC Classification Order*, ¶¶ 83, 158-61).

[16] *See, e.g.*, Order, *Motion of AT&T to be Reclassified as a Non-Dominant Carrier,* 11 FCC Rcd. 3271, ¶ 32 (1995) (*"AT&T Reclassification Order")*; Order, Authorization and Certificate, *In the Matter of British Telecom North America,* 12 FCC Rcd. 1985, ¶ 7 (1997); Memorandum Opinion and Order, *Merger of MCI Communications and British Telecommunications,* 12 FCC Rcd. 15351, ¶ 286, (1997);; Memorandum Opinion and Order, *Application of WorldCom and MCI Communications for Transfer of Control of MCI Communications to WorldCom,* 13 FCC Rcd. 18025, ¶¶ 41-2, (1998).

[17] *LEC Classification Order*, ¶¶ 100, 143.

CLECs.[18] Accordingly, the Commission again found in 2001 that "incumbent LECs retain market power in the provision of local services within their respective territories."[19]

All of the ILECs -- even the BOCs that the Commission has determined met the market-opening requirements of section 271 more than three years ago -- undoubtedly remain dominant today and retain the ability not only to raise prices above competitive levels, but to engage in cost misallocations and to discriminate against their rivals. State commissions in states where the BOCs long ago satisfied the section 271 competitive checklist have affirmed that the BOCs continue to maintain substantial market power in those states.[20] Even where the BOCs have won approval pursuant to section 271, the competing carriers that have entered the BOCs' local markets have yet to make effective strides to erode the BOCs' dominance, and do not provide reliable and ubiquitous alternative sources of supply that would constrain the BOCs' ability to misallocate costs or discriminate against rivals. The continuing ILEC control of their switched and special access bottlenecks within their in-region state jurisdictions allows them to exert market power in the downstream market, which includes all interstate and intrastate, interLATA and intraLATA retail long distance services provided within their service areas in those jurisdictions.

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[18] Selwyn Dec, ¶ 11.

[19] Report and Order, *1998 Biennial Regulatory Review*, 16 FCC Rcd. 7418, ¶ 33 (2001).

[20] *See* Texas Public Utilities Commission Letter, at 1, WC Docket 02-112 (filed May 22, 2003) ("SBC Texas continues to have dominant market share over local exchange and exchange access services"; Comments of Missouri Public Utilities Commission at 3, WC Docket 02-112 (filed July 18, 2002) (stating that "competition from widely available CLEC-owned facilities did not exist for business or residential basic local service"); *id* ("SWBT was the dominant provider of exchange access services within its service territory" and those services are "not subject to effective competition").

Because of the absence of adequate market constraints on the potential abuse of ILEC market power, following any sunset of section 272 requirements -- which are the key predicates for the Commission's present non-dominant treatment of BOC long distance services -- the BOCs should be subject to dominant carrier regulation until the Commission adopts more far reaching reforms to limit harm to competition from the BOC provision of local and long distance services through an integrated entity.

1. <u>BOCs Retain Significant Market Power Years After Section 271 Approval.</u>

Under the Commission's precedents, "control of bottleneck facilities" is "[a]n important structural characteristic of the marketplace that confers market power upon a firm" and is "prima facie evidence of market power."[21] That is so irrespective of the market share held in any downstream market for which those facilities are an essential input. Thus, the Commission applies Section 63.10 dominant carrier rules to all U.S. affiliates of foreign carriers with market power on the foreign end of U.S. international routes, without regard for the affiliates' U.S. market shares.[22] The Commission also applies similar competitive safeguards to all U.S.

[21] First Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 85 F.C.C.2d 1, ¶ 58 (1980). Thus, when the Commission first concluded that "AT&T must be treated as dominant," it did so, in part, because it concluded that "many of AT&T's competitors must have access to [AT&T's] network if they are to succeed." *Id*. ¶ 62. Conversely, when the Commission later reclassified AT&T as non-dominant, it did so, in part, because, "as a result of divestiture, AT&T no longer own[ed] bottleneck local access facilities." *AT&T Reclassification Order,* ¶ 32.

[22] 47 CFR §. 63.10; *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, 12 FCC Rcd. 23891, ¶ 161 (1997) ("*Foreign Participation Order*"). In determining whether a carrier has market power at the foreign end of a U.S. international route, the Commission presumes that carriers with greater than 50 percent market shares in any relevant foreign-end market, including international transport facilities or services, inter-city facilities or services, and local access facilities, including all incumbent local exchange carriers, possess market power. *Id*. & n. 312. *See also*, Public Notice, *The International Bureau Revises and Reissues the Commission's List of Foreign telecommunications Carriers that are Presumed to Possess Market Power in Foreign Telecommunications Markets*, DA 03-1812, Jun. 5, 2003.

international submarine cable applicants affiliated with foreign carriers that possess market power in a destination market.[23]

It is well established that market power over the local exchange bottleneck allows the incumbent carrier to undermine long distance competition through discrimination and other anticompetitive conduct.[24] The Commission concluded in the *LEC Classification Order* that "a local exchange carrier's control of the local bottleneck constitutes credible evidence that there could be a lack of competitive performance in point-to-point markets that originate in-region."[25] The Commission similarly observed in the *Non-Accounting Safeguards Order* that the BOCs were "the dominant providers of local exchange and exchange access services in their in-region

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[23] *Review of Commission Consideration of Applications under the Cable Landing License Act*, 16 FCC Rcd. 22,167,¶¶ 30-37 (2001). *See also, Bell Canada Petition for Declaratory Ruling*, 16 FCC Rcd. 12465, ¶¶ 1&10 (2001) (finding that Bell Canada, which controls "more than 95 percent of local access lines in its franchise area," failed to demonstrate that it lacks market power). *See also, id*. ("Bell Canada has the ability to discriminate against and among U.S. carriers seeking to terminate traffic in Canada by, for example, raising the price of, or withholding or degrading the quality of, terminating access its region.")

[24] In filing the antitrust suit in 1974 that led to the break-up of the Bell System, the Government "alleged that AT&T used its control over its local monopoly to preclude competition in the intercity market," and the court found "ample evidence to sustain" this contention. *United States* v. *AT&T Co.*, 552 F. Supp. 131, 161, 195 (D. D.C. 1982), *aff'd sub nom., Maryland* v. *United States*, 460 U.S. 1001 (1983). Because local monopolies controlled a "strategic bottleneck position," there were "many ways in which" the Bell System "could discriminate against competitors in the interexchange market." *Id.* at 171, 188. The local monopolies also had an obvious "incentive to discriminate": "[T]hey would stand to gain business if other carriers were disadvantaged by poor access arrangements and high tariffs." *Id*. at 188. The break-up of the Bell System was intended to remove those incentives, and BOC line of business restrictions were to be removed only "upon a showing that there is no substantial possibility that [a BOC] could use its monopoly power to impede competition." *Id*. at 165, 195. *See also*, Selwyn Dec., ¶ 50 (the 1982 Consent Decree prohibition on the BOCs offering interLATA long distance services "was adopted specifically to prevent the BOC local service monopolies from using their monopoly power in the local services market to block competition in the adjacent long distance market") & ¶ 52("BOC entry into the interLATA long distance market has created precisely the same incentive for anticompetitive conduct and market advantage as prevailed at the time the [Consent Decree] was entered.")

[25] *LEC Classification Order*, ¶ 76.

states" and, accordingly, "a BOC may have an incentive to discriminate in providing exchange access services and facilities that its affiliate's rivals need to compete in the interLATA telecommunications services and information services markets."[26] As the Supreme Court explained, "[i]t is easy to see why a company that owns a local exchange . . . would have an almost insurmountable competitive advantage, not only in routing calls within the exchange, but, through its control of this local market, in the market[] for . . . long-distance calling as well." *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646, 1662 (2002).

ILEC dominance extends to all local markets and services, but their enduring market power over access services is the direct source of their ability to impede competition in the retail market for long-distance services. Throughout the nation, AT&T and other interLATA providers remain heavily dependent upon the ILECs for access to bottleneck facilities.[27] ILECs control the local network facilities necessary to originate long distance calls from, and complete long distance calls to, virtually every mass-market customer located in their territories, as well as to the large majority of enterprise customers. Moreover, as the Commission has frequently recognized, the mere fact that a local market is technically "open" does not rid the ILEC of market power or mean that the local market is fully competitive. Rather, section 272 was premised on the fact that section 271 allows BOCs to enter long distance markets while they still

[26] *Non-Accounting Safeguards Order,* ¶¶ 10, 11.

[27] This is true regardless of the nomenclature used to describe those facilities (*i.e.*, "transport" and loops" where competitors seek unbundled elements, versus "channel mileage" and "channel terminations" in the case of special access). Comments of AT&T Corp., at 19-50, CC Docket 01-337 (filed March 1, 2002) ("AT&T Broadband Dominance Comments"); Comments of AT&T Corp., at 3-13, CC Docket No. 01-321 (filed Jan. 22, 2002) ("AT&T Special Access Comments") at 3-13.

possess overwhelming market power and thus "have both the incentive and ability to discriminate against competitors in incumbent LECs' retail markets."[28]

Nor will that market power evaporate with any sunset of section 272. Even in the largest and most competitively-advanced markets in the country, BOCs, including those that have long had interLATA authority, have been found to "continue[] to dominate the market overall" and to control "bottleneck" facilities that BOC "competitors [must] rely on."[29] Although AT&T and other competitive carriers would prefer to self-provide last-mile facilities, or obtain them from non-incumbent sources, ILECs remain the only sources for these facilities within their territories in the overwhelming majority of situations.[30] As the Commission

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[28] *SBC-Ameritech Merger Order,* ¶ 190; *Non-Accounting Safeguards Order*, ¶ 9. *See also*, Selwyn Dec., ¶¶ 58-60.

[29] *Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, Case 00-C-2051, (NYPSC June 15, 2001) ("*NYPSC Special Access Order*") at 9; *see also* Draft *Decision*, Rulemaking R.93-04-003 (filed July 23, 2002) ("*California ALJ Decision*") at 258 ("actual competition in California" has maintained its "current anemic pace"); Comments of Texas Office of Public Utility Counsel, WC Docket No. 02-148 (filed July 17, 2002) at 2-3 (describing the "extremely low levels of competitive entry in Texas" and concluding that "circumstances have not changed" because "BOCs still retain monopoly control"). *See also* Declaration of Robert Willig ¶ 13 ("Willig Decl.") (submitted in Docket No. 01-337) (March 1, 2002). In a number of ongoing proceedings before the Commission, AT&T has demonstrated that ILECs maintain market power in local markets by virtue of their control over bottleneck facilities. For example, in response to the Commission's NPRM regarding the regulatory treatment of various ILEC broadband services, AT&T submitted extensive comments and testimony (including Professor Willig's declaration) demonstrating that the ILECs possess market power in local markets that they can use to harm their rivals in the broadband market. *See* AT&T Broadband Dominance Comments, at 19-36. Likewise, in urging the Commission to adopt performance measures for ILECs' provision of special access services, AT&T demonstrated that the ILECs retain market power with respect to those services. AT&T Special Access Comments, at 3-13.

[30] In the Commission's Triennial Review proceeding, AT&T has provided substantial evidence and testimony explaining why ILECs control these facilities, and the difficulties competing carriers face in replicating them. *See, e.g.*, Reply Comments of AT&T Corp., CC Docket No. 01-338, at 144-87, 244-68 (filed July 17, 2002) ("AT&T Triennial Review Reply Comments"); *id*. Exh. C, Reply Declaration of Anthony Fea and Anthony Giovannucci, ("Fea/Giovannucci

(continued . . .)

recognized in the *UNE Remand Order*, self-provisioning is not a viable alternative because "replicat[ion of] an incumbent's vast and ubiquitous network would be prohibitively expensive and delay competitive entry."[31] The ILECs have ubiquitous transport facilities that connect 14,000 local serving offices and over 220 million loops.[32] No CLEC or IXC can hope to replicate this network.[33]

Indeed, according to the just-released *FCC Local Competition Report* for the year ending December 2002, nationally some 96.6 percent of all switched access lines were either being served directly by their ILEC or by a CLEC utilizing ILEC-provided facilities (resale or UNE).[34] Accordingly, there are not yet significant alternative sources of supply to the incumbents' bottleneck facilities. Additionally, the UNE-based competition that the 1996 Act was intended to foster has been stifled by the BOCs' high UNE rates and poor provisioning, and in recent years, bankruptcy has been more prevalent than new market entry among CLECs.

Nor does out-of-region entry into local markets by adjacent BOCs appear at all likely. As Dr. Selwyn describes, since the 1996 Act, the BOCs have notably declined all opportunities to compete with other BOCs on an out-of-region basis, except for services like

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Reply Dec."); *see also* Declaration of Anthony Fea and William Taggart, CC Docket No. 96-98 (filed April 30, 2001, appended to Comments of AT&T) ("Fea/Taggart Dec").

[31] Third Report And Order And Further Notice Of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd. 3696 , ¶ 182 (1999) ("*UNE Remand Order*"); *see also* AT&T Triennial Review Reply Comments at 144-87, 244-68; Fea/Giovannucci Reply Dec.

[32] *See* Federal-State Joint Board, *Universal Service Monitoring Report*, CC Docket 96-45, Tables 10.1, 10.2 (Oct. 2001).

[33] *See Verizon*, 122 S. Ct. at 1662. *See also*, Selwyn Dec., ¶ 16-17 (explaining higher costs faced by CLECs in constructing facilities) & ¶ 17 ("subscriber loops are a 'natural monopoly' by any traditional standard").

[34] Selwyn Dec., ¶ 11.

calling cards that may be marketed to in-region customers, and have only offered local and long-distance services on an in-region basis where they may leverage their local bottlenecks.[35] Moreover, by not competing against other BOCs, each BOC avoids provoking competition from other BOCs in its own monopoly markets.[36]

There are no meaningful alternative platforms that would replace the ILEC local bottleneck. Although cable-delivered telephone service holds promise, it is available in few communities today.[37] And, with very limited and marginal exceptions, consumers are not replacing their wireline phones with wireless phones. Most consumer and business end-users who subscribe to wireless service also subscribe to wireline service. This is evidenced by the

[35] Selwyn Dec**.,** ¶¶ 56-57. Indeed, SBC does not even offer long distances services to customers of other LECs or CLECs within its section 271-authorized states. *Id*., ¶ 57.

[36] *Id.*, ¶ 28. Qwest Chairman (and former Ameritech Chairman) Richard Notebaert has stated that competing for local customers currently served by Ameritech "might be a good way [for Qwest] to turn a quick dollar" but "that doesn't make it right.'" Chicago Tribune, 'Ameritech Customers Off-Limits: Notebaert,' Oct. 31, 2002. Likewise, in an analyst conference call held the same week, Mr. Notebaert was asked why, if the rules implementing the Telecom Act were so favorable to new entrants, Qwest was not taking advantage of them to enter adjacent local markets. Mr. Notebaert responded that because Qwest was now opposing these rules, it would be "contradictory for us to take advantage of it" and compete with the other Bells. Fair Disclosure Wire, 'Brief of Qwest Third Quarter 2002 Earnings Conference Call,' October 30, 2002 Verizon and SBC-Ameritech, despite commitments to engage in such competition as a condition of their merger approvals, have similarly failed to compete meaningfully in out-of-region local markets. Selwyn Dec., ¶ 28. *See also* Memorandum Opinion and Order, *In re Application of GTE Corp, Transferor and Bell Atlantic, Transferee,* 15 FCC Rcd. 14032, ¶¶ 319-323, (2000); *SBC/Ameritech Merger Order, ¶¶ 398-399, ¶ 60 of Appendix C*

[37] Cable service is available to many (but not all) residential customers; it is generally not available to businesses because cable systems generally do not extend to business districts. See Declaration of Robert Willing appended as Exhibit A to AT&T's Comments in *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, March 1, 2002 ¶¶ 10, 13.

fact that Verizon and SBC/Cingular are offering bundled packages including wireline and wireless service.[38]

In New York, where it has been more than three years since the BOC was granted section 271 authority, the most recent FCC *Local Competition Report* shows that CLEC market share growth has not progressed in the past year.[39] Moreover, CLECs serve less than 4 percent of end-user switched access lines in New York with CLEC-owned facilities.[40] The Texas PUC reported last year that the level of market penetration was "too low to declare that full competition has arrived."[41] Further, "a number of key competitors" were forced by market conditions to "limit[] their entry" and have "not been offering substantial competition" in bundled offerings of services.[42] Under these conditions, new entrants can do little to constrain anticompetitive practices of the dominant BOC.

Critically, Verizon retains its dominance in New York, where section 272 has already sunset, and SBC retains its dominance in Texas, where section 272 is poised to sunset unless extended by the Commission, although these states are among the country's most active

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[38] *See U.S. Regional Bell Operating Companies in Long Distance, 2003-2008,* Atlantic ACM, at 0 (2003).

[39] *Local Telephone Competition: Status as of December 31, 2002,* FCC Wireline Competition Bureau, Industry Analysis and Technology Division, June 2003, Table 7 (CLEC share of end-user switched access lines remained at 25 percent from December 2001 through December 2002).

[40] *See id.*, Tables 6 & 10.

[41] *See* Comments of Texas Office of Public Utility Counsel, WC Docket No. 02-148, at 2 (filed July 17, 2002) (quoting Report to the 77th Texas Legislature, *Scope of Competition in Telecommunications Markets of Texas*, January 2001, p. ix-x).

[42] *Id.*; Texas Public Utility Commission Letter, at 1 ("Two years [after SBC Texas was granted 271 authorization], competition in the local market is still emerging, and many competitors are struggling to remain financially viable" (quoting Report to 78th Texas Legislature, *Scope of Competition in Telecommunications Markets of Texas,* January 2003, at 37)).

markets and ones in which state regulators have demonstrated a strong commitment to fostering local competition. But in many other states where the BOC has section 271 authority, competitive entry has been more limited. For example, in three of the five states in which BOCs won section 271 approval in 2001, Arkansas, Connecticut and Missouri, CLEC market shares are 10 percent or less.[43] And nationwide, only about a quarter of CLEC-served end user switched access lines are served by CLEC-owned facilities.[44]

Therefore, any expectation that BOC market power will entirely – or even significantly -- dissipate by the time of any sunset of the Commission's section 272 requirements does not reflect actual marketplace conditions. In fact, the overwhelming real world evidence demonstrates the opposite: that BOC local market power is not significantly reduced, even years after they win approval pursuant to section 271 to offer in-region, interLATA services.

2. ILEC Control of the Local Bottleneck Confers Market Power In All Downstream Markets.

IXCs can compete effectively against an ILEC offering both local and long distance services *only* if they receive access on the same terms and conditions and at the same economic cost as ILEC long distance services.[45] Both the switched access services used by IXCs to provide long distance services to mass market and enterprise customers, and the special access services for the dedicated, high capacity network facilities used to supply long distance services to many enterprise customers, provide the incumbents with artificial cost and other competitive advantages that allow them to leverage their local bottlenecks into long distance markets.

[43] *Local Telephone Competition: Status as of December 31, 2002,* FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, June 2003, Table 7.

[44] *See id*., Table 10.

[45] *See* Selwyn Dec., ¶109.

Switched Access. IXCs still generally have no alternative to the incumbents' switched access services, which remain far above economic cost -- both for interstate calls, where current BOC access charges are far above cost-based levels, as well as for intrastrate long-distance (interLATA) calls, where current access charges are as much as *ten times* greater than cost than interstate charges. [46] Because Commission rules allow IXCs to use UNEs to originate and complete long distance calls *only* where they use UNEs to provide local service to the relevant calling and called numbers, and each IXC has only a small fraction of local service customers, IXCs must continue to purchase originating and terminating switched access services to originate and/or complete virtually all of their customers' long distance calls.

Even the development of local facilities-based competition fails to constrain the incumbents' high switched access charges. Many competitive carriers that have entered local markets have imposed higher switched access rates that those charged by the BOCs -- causing the Commission to limit the switched access rates that CLECs may charge.[47] Under these market conditions, where even many CLECs are pricing at supracompetitive rates, there can be no doubt that competitive entry in local services provides no constraint on the incumbents' ability to use switched access to discriminate against competing IXCs. Therefore, the ILECs undoubtedly maintain market power over switched access services.

Special Access. As AT&T has amply demonstrated, in the vast majority of cases there are no alternatives to the BOCs' and other ILECs' special access services that AT&T and

[46] *Id.,* ¶ 44.

[47] Seventh Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 16 FCC Rcd. 9923, ¶¶ 2, 22, 45 (2001). *See also, id*., ¶ 30 (finding that even those carriers obtain a "series of bottleneck monopolies over access to each individual end user").

other IXCs must use to provide services to enterprise customers.[48] ILEC special access services also are a critical input for suppliers of local, wireless and broadband services.[49] The facilities-based competition the Commission anticipated in allowing pricing flexibility for these services has not materialized, and is unlikely to do so, and CLEC alternatives exist in only a very small percentage of cases.[50] BOC claims to the contrary have been shown to be wildly exaggerated and based in part on a methodology that treats CLEC purchase of special access as CLEC self-deployment of their own loops, thus vastly inflating the "CLEC share" of deployed facilities.[51] In most cases, it is simply not feasible for competitors to build facilities directly to the end user's premises.[52]

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[48] *See* AT&T Petition for Rulemaking (filed Oct. 15, 2002), RM No. 10593, at 25-28; AT&T Reply Comments (filed Jan. 23, 2003), RM No. 10593, at 10-20. AT&T incorporates its Petition and Reply Comments, and their attachments, herein by reference. *See also, e.g.*, Comments of Sprint Corporation, *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket No. 01-321, at 5-6 (Jan. 22, 2002) (noting that it "continues to rely upon the ILECs for approximately 93% of its total special access needs despite aggressive attempts to self-supply and to switch to facilities offered by alternative access vendors (AAVs) whenever feasible"); Comments of WorldCom, Inc., CC Docket No. 01-321, at 9-10 (Jan. 22, 2002) (explaining that "[i]n the past year, approximately 90 percent of . . . [its] off-net special access circuit needs were provisioned by the incumbent LECs, even though it is . . . [its] policy to use the local facilities of WorldCom or other competitive carriers whenever such facilities are available"); Comments of VoiceStream Wireless Corporation, CC Docket No. 01-321, at 3 (Jan. 22, 2002) ("CMRS carriers remain heavily dependent on the special access facilities provided by the ILECs."); Reply Comments of Sprint Corporation, CC Docket No. 01-321, at 2 (Feb. 12, 2002) ("There is virtual unanimity among commenting IXCs, CLECs, CMRS providers, and large end users that ILECs remain dominant in the provision of special access services"); Reply Comments of Cable & Wireless USA, Inc., CC Docket No. 01-321, at 2-11 (Feb. 12, 2002).

[49] AT&T Reply Comments, RM No. 10593, at 43-46.

[50] *Id*., at 13.

[51] *Id*. at 12-19 & Reply Dec. of Lee L. Selwyn, ¶ 42.

[52] New network construction typically requires cooperation from localities, other carriers, and building owners and can take months or even years to complete. Most end users are unwilling to deal with these delays. Even in those limited instances in which it is economically feasible to deploy facilities, CLECs face a number of hurdles that frustrate the self-deployment of facilities, including the need to obtain access to rights-of-way and buildings, existing ILEC volume or term

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Even Verizon has admitted in the Special Access proceeding that CLEC-owned facilities serve at most 30,000 buildings nationwide -- a tiny fraction of the commercial buildings in the United States.[53] In the largest cities with the most competitive entry, the BOC remains the only facilities-based option in the vast majority of buildings. Indeed, Verizon is the only available facilities-based option in 85.9 percent of the buildings served by AT&T in New York[54] and 86.5 percent of the buildings served by AT&T in Boston, and SBC is the only available facilities-based option in 95.4 percent of the buildings served by AT&T in Los Angeles and 94 percent of the buildings served by AT&T in Chicago.[55]

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commitments, exhaustion of collocation capacity, and long distances between points of presence and ILECs' end offices. AT&T Petition for Rulemaking, RM No. 10593, at 28-32. *See also,* Fea/Taggart Dec., ¶¶ 30-31;AT&T Triennial Review Reply Comments at 144-87, 244-68; Fea/Giovannucci Reply Dec.

[53] AT&T Reply Comments, RM No. 10593, at 12-13.

[54] *Id.*, Reply Declaration of Lee L. Selwyn, ¶ 20. The findings of the New York Public Service Commission ("NYPSC") that Verizon remains the "dominant" provider of special access services in *all* of that state, *including* lower Manhattan – the area that is generally regarded as the *most* competitive in the United States – is compelling proof of the BOCs' continuing market power. *NYPSC Special Access Order* at 6-9. The NYPSC carefully analyzed a detailed record regarding route miles of fiber, numbers of buildings passed and especially numbers of buildings actually *connected* to ILEC competitors, and concluded that "Verizon's combined market share data demonstrates its continued dominance in *all* geographic areas. . . . In [New York City], for example, Verizon has 8,311 miles of fiber compared to a few hundred for most competing carriers; Verizon has 7,364 buildings on a fiber network compared to less than 1,000 for most competing carriers." *Id.* at 7. Verizon's own data show that "a maximum of 900 buildings [are] served by individual competitors' fiber facilities," but New York City has "775,000 buildings in the entire city, over 220,000 of which are mixed use, commercial, industrial, or public institutions." *Id*. at 7-8 (citing to Land Use Facts, Department of City Planning). The NYPSC further concluded that claims regarding "buildings passed" by competitors' facilities were virtually meaningless as evidence of a competitive market because "the data do not reflect how often fiber actually enters those buildings." *Id.* at 9. "Because competitors rely on Verizon's facilities, particularly its local loops," the NYPSC found, "Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services." *Id.* The NYPSC thus concluded that "Verizon's combined market share data demonstrate its continued dominance in *all* geographic areas" *Id.* at 9 (emphasis added).

[55] AT&T Reply Comments, RM No. 10593 at 14; *id*., Reply Declaration of Lee L. Selwyn, ¶ 20.

Moreover, as described by Dr. Selwyn, because access line facilities are not fungible from one location to another, CLEC ownership of facilities to specific buildings in a zip code does not make those facilities ubiquitously available throughout that or any other zip code.[56] These low supply elasticities mean that CLECs cannot respond rapidly or often at all to ILEC price increases by expanding their own facilities, and therefore cannot constrain ILEC price increases.[57]

For confirmation of the incumbent-controlled special access bottleneck, the Commission need look no further than New York, which is generally thought to be the most competitive market in the U.S. If competitors cannot self-deploy loop and transport facilities in New York City, they are likely to be even more dependent upon incumbent facilities in other parts of the United States. The New York Public Service Commission characterized Verizon as the "dominant" provider of special access services, based on an examination of route miles of fiber, numbers of buildings passed, and the number of buildings actually connected to the non-ILECs. The New York Commission found that Verizon "continues to occupy the dominant position in the Special Services [*i.e.*, special access] market, and its dominance is a controlling factor in that market. *Because competitors rely on Verizon's facilities, particularly its local loops, Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services*."[58]

The continuing ILEC control of the local bottleneck, whose persistence is assured by the near-zero supply-elasticity of competing local service providers, confers market power in

[56] Selwyn Dec., ¶ 14.

[57] *Id*.

[58] NYPSC Special Access Order, at 9 (emphasis added).

all downstream markets irrespective of how those downstream markets are defined and allows the ILECs to raise price and restrict output in all those downstream markets.[59] As Dr. Selwyn demonstrates, under the criteria identified in the 1992 Merger Guidelines,[60] control of the access bottleneck allows the BOCs to dominate all interstate and intrastate, interLATA and intraLATA long distance services, within their in-state and in-region footprint.[61] His conclusion is based, *inter alia*, on technical considerations (the common line), and buyers' and sellers' perceptions and conduct, particularly BOCs' self-limitation of their competitive activities to in-region footprint, and their offering, by state, of single flat-rate offerings for bundled intrastate, interstate, intraLATA and interLATA (and in some cases international) services, and customers' inability to make separate PICs for *interstate* and *intrastate* interLATA services.[62]

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[59] Selwyn Dec., ¶ 18 ("[N]ear-zero CLEC supply elasticity affords the BOCs the ability to control and limit output in the downstream market by raising the costs of downstream competitors' inputs, which also forces retail prices being charged by downstream firms to be higher than they would otherwise be. This, in turn, provides the BOCs with a price umbrella for their own retail services, resulting in higher BOC rates and reduced BOC output as well").

[60] The Commission has adopted the approach taken in the *1992 Merger Guidelines* for the purposes of defining markets, *LEC Classification Order*, ¶ 25 noting that the differing objectives of regulation and antitrust enforcement may affect the application of the market definition in these contexts. *See,* Sections 2.12 and 2.32 of the Merger Guidelines for the relevant evidence to be considered in defining product and geographic markets.

[61] *See* Selwyn Dec., ¶ 14 ("BOCs must continue to be classified as *dominant* carriers with respect to *any service* that is linked to the access line platform, including and especially any long distance services that are bundled with basic local exchange under a single package.")

[62] *Id.,* ¶¶ 14, 31-33, 37-44. *See also, id.,* ¶ 38 (noting that "[c]ustomers cannot and do not make separate service provider selections *notwithstanding the fact that the two services are subject to different regulatory treatment by different regulatory jurisdictions and may be offered at different prices*.") It is also sometimes useful to distinguish between the "mass market" (residential and small business), which IXCs generally serve by using ILEC switched access services, and the "business enterprise" market, which IXCs generally serve by using ILEC special access services, although, as described above, the ILECs have bottleneck control over both switched and special access. Notice, ¶ 10. Because the ILEC bottleneck also confers market power over international long distance services, no separate analysis is necessary for international services. *See* Notice, ¶ 16. The substitution of Internet-based services for

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It is also clear that non-wireline alternatives do not in any way detract from ILEC bottleneck market power. As noted above, although cable-delivered telephone service holds promise, it is available in few communities today. And, as noted above, few consumers have substituted wireless for wireline phones.

II. ILEC CONTROL OF BOTTLENECK FACILITIES CONFERS THE MARKET POWER TO ENGAGE IN PRICE SQUEEZES, MISALLOCATE COSTS AND DISCRIMINATE AGAINST UNAFFILIATED INTERLATA COMPETITORS.

The incumbents' market power over access facilities allows them to leverage that power to favor their own long distance (and local) services and disfavor those of competitors. Thus, the BOCs do not merely retain their historic *ability* to discriminate and engage in other anticompetitive conduct through their control of the local bottleneck. Their *incentive* to engage in such misconduct rises substantially when they enter long distance markets following the grant of section 271 relief and they must also compete for local service -- often against the very companies they compete with in long distance markets and which depend on BOC facilities to compete in both areas.

As the Notice (¶ 31) acknowledges, "the Commission previously has found that [the BOCs and independent LECs] might leverage their market power in the local exchange and exchange access markets through cost misallocation, raising their rivals' costs, improper discrimination to gain an advantage in the interexchange telecommunications services market, or a predatory price squeeze." Thus, the *LEC Classification Order* recognized that "as long as the BOCs retain control of local bottleneck facilities, they could potentially engage in improper cost allocation, discrimination, and other anticompetitive conduct to favor their affiliates' in region,

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international services provided by wireline operators, *id*., has been very limited and does not prevent ILEC leverage of their local bottlenecks against downstream wireline providers.

interLATA services."[63] Moreover, their ability to engage in such conduct would be heightened by any sunset of section 272's separate affiliate requirements.

Subsequent experience has shown the accuracy of that prediction. First, as described by Dr. Selwyn, the BOCs have entered long distance markets only in their in-region service areas, where they may exploit their local market power.[64] Except for services like calling cards that could be marketed to in-region customers, the BOCs have not sought to compete out of region. Notably, SBC does not even offer long distance services to local customers of CLECs or other ILECs in states where it has received section 271 authorization.[65] Second, as described below, the BOCs, including those that have long had interLATA authority, use their bottleneck control to misallocate costs and to discriminate against unaffiliated interLATA service providers. It is quite clear that the BOCs have in fact exercised their market power to harm interLATA competition in the ways the Commission anticipated in 1997 notwithstanding the existence of section 272 safeguards.[66]

The evidence compiled here shows that the BOCs' anticompetitive misconduct remains a serious problem today and will remain so long after any sunset of section 272 -- which

[63] *LEC Classification Order*, ¶ 134. It also made similar findings with regard to the independent LECs. *Id*., ¶¶ 159-161. *See also Non-Accounting Safeguards Order* ¶¶ 9-13; *Verizon*, 122 S. Ct. at 1662 (The carrier that controls the "local loop plant" could "place conditions or fees . . . on long-distance carriers seeking to connect with its network"). Similarly, the Commission has found that "incumbent LECs . . . have the incentive and ability" to use their control over bottleneck facilities "to discriminate against competitors in the provision of advanced services" and to restrict their output. *SBC-Ameritech Merger Order* ¶ 186; *see id.* ¶¶ 196-97.

[64] Selwyn Dec., ¶ 32.

[65] *Id.*

[66] These following examples confirm both the BOCs' incentive and ability to harm long distance competition and their continuing local market power. The Commission has long recognized that evidence that a BOC is, in fact, able to misallocate costs or to engage in discriminatory conduct is direct evidence of market power. *E.g., SBC-Ameritech Merger Order* ¶ 107.

would only make such misconduct even more difficult to detect and remedy. This danger was explicitly acknowledged by the Supreme Court, which recognized that "*In an unregulated world*, another telecommunications carrier would be forced to comply with the[] conditions" the incumbent local carrier imposed, or else the competing carrier "could never reach the customers of a local exchange."[67]

1. BOCs Are Engaging in Price Squeezes By Setting Their Long Distance Rates At or Below Their Switched Access Prices.

Because BOCs control the facilities used to provide access services, which are a key input into long distance services, the BOCs have strong incentive to price access services at rates above their cost. That, of course, enables the BOC to offer its own long distance services at prices that undercut those that can profitably be charged by rival IXCs. The Commission described the different ways in which the BOCs may price squeeze their IXC competitors as follows:

> "Absent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. . . . The incumbent LEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins. If the competing in-region, interexchange providers raised their prices to recover the increased access charges, the incumbent LEC's interexchange affiliate could seek to expand its market share by not matching the price increase. *The incumbent LEC affiliate could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share*."[68]

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[67] *Verizon*, 122 S. Ct. at 1662 (emphasis added).

[68] First Report and Order, *Access Reform Order*, 12 FCC Rcd. 15982, ¶ 277 (1997) (emphasis added).

In describing how a BOC could engage in a price squeeze by setting its interexchange prices at or below its access rates, the Commission responded to BOC claims that any increased interexchange revenues could be offset by reduced access revenues from IXCs. In the *LEC Classification Order*, the Commission explained that: (1) the BOCs higher interexchange revenues would more than offset lost access revenues if the lower BOC interexchange rates sufficiently increased demand, and (2) the BOC would receive increased access revenues if IXCs reduced their interexchange rates to match the lower BOC interexchange rates.[69] As described below and in the attached Selwyn declaration, there is considerable evidence that BOCs -- including BOCs that have long held section 271 authority -- are in fact misusing their access bottlenecks by engaging in such price squeezes.[70]

Texas: As AT&T explained in a complaint with the Public Utility Commission of Texas, SBC's long distance affiliate has offered intrastate long distance services at very low rates that are nearly equal to SBC's intrastate access charges and thus could not possibly allow the SBC affiliate to cover all of its costs.[71] Some of the plans offered by SBC's long distance affiliate offer long distance service for as low as *6 cents* per minute for residential customers and as low as *7 cents* per minute for business customers. *AT&T Texas Price Squeeze Complaint* at 6-7. Yet the access charge that applies to a residential intrastate long distance call between SBC customers is about *5.67 cents* per minute. *Id.* at 7. On such calls, absent all other costs, SBC's affiliate would gain net revenue of just a few tenths of a cent. However, it is evident that the

[69] *LEC Classification Order*, ¶127.

[70] *See* Selwyn Dec., ¶¶ 43-48, 84-88, 96.

[71] *See* Second Amended Complaint of AT&T Communications of Texas, L.P., SOAH Docket No. 473-01-1558, Docket No. 23063 (Texas P.U.C. filed Dec. 5, 2001) ("*AT&T Texas Price Squeeze Complaint*").

affiliate's own operating expenses are significant, and together with the access cost, far exceed the retail rates that SBC's affiliate is charging. Indeed, based upon agreements that SBC has summarized as a result of its section 272 obligations, AT&T has been able to estimate that the SBC long distance affiliate incurs billing and marketing expenses of at least 3.4 cents per minute. *Id.* at 8. However, even if the SBC long distance affiliate loses money on these calls, the SBC entity as a whole has realized a net profit.[72] Based on these pricing patterns, SBC's long distance rates appear to be well below-cost, result in a price squeeze, and are anti-competitive. *Id.*

Virginia: Similarly, in a complaint recently filed with the Virginia State Corporation Commission, AT&T has explained that Verizon is using above-cost intrastate access rates to price squeeze AT&T and other IXCs.[73] Verizon's long distance affiliate offers long distance plans, particularly its bundled "Freedom" plans, that include unlimited long distance calling at effective retail rates that are substantially *lower* than its access charges to unaffiliated IXCs.[74] For the overwhelming majority of AT&T's Virginia in-state long distance calls, which

[72] SBC seeks to maximize the profit of the entire entity, and is indifferent to whether its long distance affiliate makes money. In fact, this was made particularly evident when SBC witnesses provided testimony before the Texas legislature regarding proposed tax legislation that would eliminate the ability of a surviving corporation in a merger to carry forward the losses of the other merged company. The SBC witness stated that SBC plans to merge its affiliates into its BOC operations when it is permitted, and that SBC will want to use the losses of those companies to offset any profits of the BOC. Partial Tr., Before the Senate Comm. on Finance, Austin, Texas, *Relating to the Franchise Tax*, S. Bill 1689 (Testimony of T. Leahy, SBC, Apr. 19, 2001).

[73] Petition of AT&T Communications of Virginia, LLC., *AT&T Communications of Virginia, LLC., v. Verizon Virginia, Inc., et al.*, PUC-2003-00091, May 8, 2003 ("*AT&T Virginia Price Squeeze Complaint*"). *See also*, Response of AT&T Communications of Virginia, LLC., *AT&T Communications of Virginia, LLC., v. Verizon Virginia, Inc., et al.*, PUC-2003-00091, Jun. 17, 2003 ("*AT&T Virginia Price Squeeze Response")*.

[74] *AT&T Virginia Price Squeeze Complaint* at 4.

continue to originate from and terminate to Verizon local exchange customers, AT&T pays access charges to Verizon averaging almost 8 cents per minute.[75] Because Verizon's net cost of providing originating and terminating access is less than one cent per minute, AT&T and other IXCs are providing a subsidy to Verizon of 7 cents per minute on all these calls.[76] At the same time, Verizon's long distance affiliate is using this 7-cent per minute corporate access cost advantage to subject AT&T and other IXCs to an anticompetitive price squeeze through long distance plans pricing intrastate toll calls as low as 4 or 5 cents per minute.[77] Verizon's "Veriations Freedom" service is presently offered in five other states in addition to Virginia.

As noted by Dr. Selwyn, Verizon responded to AT&T's Virginia price squeeze complaint by contending that IXCs provided equivalent service packages -- but neglected to mention that IXCs can provide such packages only if they are also CLECs.[78] Significantly, Verizon made no claim that IXCs providing long distance services on a stand-alone basis -- which they must do to compete for the vast majority of mass market customers in BOC territories -- can compete with Verizon's long distance rates.[79]

Washington: AT&T has also shown that Verizon engages in anticompetitive price squeeze activities in the state of Washington, where Verizon's tariffed switched access charges and other costs are 13.44 cents per minute to provide intrastate toll services, yet all but

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[75] *AT&T Virginia Price Squeeze Response* at 3.

[76] *See id*. at 4 & n.11.

[77] *AT&T Virginia Price Squeeze Complaint* at 3-4. *See also*, Selwyn Dec., ¶¶ 47-48 (showing that the average price of interLATA calling under Verizon "Freedom" plans is approximately 4.3 cents per minute).

[78] Selwyn Dec. ¶ 49.

[79] *Id*.

two of its intrastate long distance toll calling plans for business and residential customers charge rates of 7.9 cents to 10.86 cents per minute.[80]

As explained in Dr. Selwyn's testimony, the BOCs' own expert economists have themselves provided the theoretical explanation that corroborates the practical evidence of this pricing pattern.[81] These BOC economists claim that two affiliated companies that have a vertical supplier-customer relationship -- as do a BOC and its interLATA affiliate -- will engage in "double marginalization," which results in the companies setting the price of the "downstream product" (*i.e.*, long distance) to "maximize its profits jointly."[82] That occurs, these economists assert, because the BOC retains an "access margin," or access rates above cost, which makes it profitable for the entity as a whole to lower the price of long distance, regardless of the stand-alone profit of the downstream company.[83] Of course, if section 272 separation safeguards no longer apply, the incentives and ability to engage in such conduct are even greater.

2. <u>BOCs Are Engaging in Price Squeezes By Raising Their Special Access Rates.</u>

The BOCs also are using their special access bottlenecks to price squeeze IXC competitors in the other manner described in the Commission's *Access Charge Reform Order* -- by *raising* the price of special access services to all interexchange carriers, thus causing competing IXCs (as well as cellular, broadband and local service providers that also use the BOCs' special access services as essential inputs) "to either raise their retail rates to maintain

[80] Complaint, AT&T Communications of the Pacific Northwest, Inc., v. Verizon Northwest Inc., Dkt No. UT-020406, Apr. 3, 2002. *See also*, Affidavit of Lee L. Selwyn, Dkt. No. UT-030395, Washington Utilities and Transportation Commission, Apr. 14, 2003 (showing that Verizon's "Freedom" packages provide intrastate calling at 4.3 cents per minute, which is far below switched access charges).

[81] Selwyn Dec., ¶ 62.

[82] *See id.* (citing BOC expert report).

their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins."[84]

Far from using special access pricing flexibility to *reduce* special rates to meet the competition that the BOCs claimed to exist in these services -- which was the principal purpose and central prediction underlying the Commission's *Pricing Flexibility Order* -- BOC special access rates are now higher in pricing flexibility areas than in price capped areas, and BellSouth, Verizon and Qwest have raised special access rates *in every MSA* in which they have received Phase II pricing relief.[85] BOC ARMIS reports show special access rates of return for 2001 of 49.26 percent for BellSouth, 46.58 percent for Qwest, 54.60 percent for SBC, and 21.72 percent for Verizon (or 37.08 percent for Verizon excluding NYNEX), as compared to the 11.25 percent rate of return the Commission found just and reasonable for dominant ILEC services in 1990. The BOCs are thus reaping huge monopoly profits.[86] Indeed, a study filed with the Commission on June 12, 2003, concludes that the Bells are receiving at least $5.6 billion in windfall profits annually through their exploitation of this last mile monopoly.[87] These excessive special access prices raise the costs of suppliers in downstream long distance, local services, cellular and

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[83] *Id.*

[84] *Access Reform Order*, 12 FCC Rcd. 15982, ¶ 277

[85] Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, et al., 14 FCC Rcd. 14221, ¶ 154 (1999) ("*Pricing Flexibility Order*"); AT&T Reply Comments, RM No. 10593, at 21-22.

[86] *See* AT&T Petition for Rulemaking, RM No. 10593, at 8 and Reply Declaration of Lee L. Selwyn Dec, Table 12.& Friedlander Dec. ¶¶ 2-4, Exhibit 1.

[87] *See* Rappoport, Taylor, Menko, Brand, *Macroeconomic Benefits from a Reduction in Special Access Price* (Jun. 12, 2003), filed in RM Docket No. 10593, at 5.

broadband markets that rely on these services as essential inputs, and allow BOCs competing in these downstream markets to price squeeze their rivals.[88]

Moreover, the extent of the artificial competitive advantage in downstream markets the BOCs' special access bottlenecks confer is far greater than is shown by the BOCs' ARMIS reports. That is because the BOCs' true costs of providing these services are their much lower forward-looking economic costs, rather than the embedded costs contained in ARMIS reports.[89] Indeed, the BOCs' special access rates are multiples of their economic costs, further demonstrating that these are monopoly services not subject to any meaningful competitive discipline, and that BOCs' downstream competitors that must rely on these services face a major competitive handicap.[90] A further demonstration of the huge advantages conferred by the BOCs' special access bottlenecks is the fact that they have more than a 90 percent share of *intra*LATA Frame relay and ATM services.[91]

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[88] AT&T Reply Comments, RM No. 10593, at 43-47.

[89] AT&T Petition for Rulemaking, RM No. 10593, at 10-11.

[90] *See id*. & Stith Decl.

[91] AT&T Reply Comments, RM No. 10593, at 43-47. In a recent *ex parte*, Qwest cites to *national* market share statistics for ATM and frame relay services to bolster its claim that BOCs lack market power in the provision of broadband services to large business customers. *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket Nos. 02-33 and 01-337 and CS Docket No. 02-52, Letter dated May 23 2003 from Cronan O'Connell, Qwest, to Marlene H. Dortch, FCC. However, such statistics are irrelevant in assessing BOC market power because, until recently, the Bells have been restricted to local markets. The more pertinent question is how the Bells have fared in their provision of *local* data services, and the Qwest *ex parte* demonstrates convincingly that the BOCs have used their local bottleneck to dominate local data services. For example, Qwest's own submission shows that the BOCs account for 90.3 percent of frame relay services local revenues, and that no non-BOC accounts for more than 3 percent of such revenues. *Id.* at 15. The competitive picture is even bleaker with respect to ATM services. There, the BOCs account for roughly 97 percent of ATM local revenues. *Id*. at 16.

3. The BOCs Have Abused Their Local Bottlenecks By Engaging In Other Forms of Discriminatory Conduct that Disadvantages Their InterLATA Competitors.

The *LEC Classification Order* predicted that "there are various ways in which a BOC could attempt to discriminate against unaffiliated interLATA carriers, such as through poorer quality interconnection arrangements or unnecessary delays in satisfying its competitors' requests to interconnect to the BOC's network."[92] The accuracy of the Commission's predictions is confirmed -- once again -- by the BOC discriminatory conduct relating to the provisioning of special access, so-called "growth" discounts in switched access and the PIC process.

Provisioning of Special Access. One of the most competitively harmful ways in which BOCs are abusing their market power is in their discriminatory performance in providing special access services to IXCs that compete with the BOCs' interLATA affiliates. As described above, the BOCs retain significant market power over the provision of the special access facilities that are a critical input for IXCs. Timely and accurate provisioning, repair, and maintenance of special access services are critical for IXCs to make firm service commitments and to assure quality service for their end user customers.[93] BOC performance on these critical aspects of special access service shows a consistent pattern of poor quality, delays, and other discrimination against rival IXCs.

Several state commissions have investigated the BOCs' special access performance and determined that it is entirely inadequate and discriminatory. The NYPSC has ruled that the evidence before it demonstrated that Verizon "provides special wholesale services

[92] *LEC Classification Order*, ¶ 111, citing *Non-Accounting Safeguards NPRM*, ¶ 139.

[93] *See NYPSC Special Access Order* at 10 (special access services "are crucial for the development of facilities-based competition").

in a discriminatory manner."[94] The data compiled by the NYPSC suggested that Verizon missed very few provisioning appointments for its retail customers, but missed over 25 percent of appointments scheduled by rival IXCs.[95] The NYPSC found that "these delays indicate Verizon's provision of Special [Access] Services is below the threshold of acceptable quality" and that "Verizon treats other carriers *less favorably* than its retail customers."[96] Significantly, these state commission findings of discriminatory performance were made for the local market that is the most developed in the country. Almost three years after Verizon's affiliate began providing in-region interLATA services, the PSC found that Verizon remained the dominant provider of special access in *all* areas of New York, and that its performance in providing those critical inputs was both inferior *and* discriminatory.

These NYPSC findings were corroborated by the Biennial Audit performed for Verizon. The audit collected data on four aspects of special access performance: average installation interval, installation commitments met, average repair interval, and total trouble reports. Even though the audit measurements were insufficient in a number of fundamental respects,[97] the limited data that were provided in the audit confirmed that Verizon's special

[94] *Id.* at 6. The NYPSC found that Verizon's "provision of Special [Access] Services . . . began to deteriorate during 1995, and continued to decline in 1996." *NYPSC Special Access Order* at 4. Even "one full year" after the NYPSC acted to require Verizon to improve service quality, the "service results were mixed, at best." *Id.* at 4. Although some improvement was made in 1998 (notably, the time period in which Verizon was seeking the NYPSC's support for its section 271 application), the NYSPC found that it "was not sustained." *Id.*

[95] *Id.* at 5.

[96] *Id.* (emphasis added).

[97] Most notably, Verizon simply failed to collect or maintain much of the data that is necessary to measure its special access performance. For example, the relevant performance data was often retained for a period shorter than the nine months that the audits attempted to examine. Comments of AT&T Corp. CC Docket 96-150, at 19 (filed Apr. 8, 2002); ("AT&T Audit Comments").

access performance was blatantly discriminatory. For example, the data showed that installation of special access services for non-affiliated carriers took far longer than for Verizon 272 affiliates: in June, 2000, the mean for installation of high speed special access for Verizon affiliates was just 9.9 days, but was 25.3 days for competitors.[98] In fact, review of virtually *every* report for each of the four special access performance measures indicates that Verizon's affiliates received more favorable service than competitors.[99]

Several other state commissions have also concluded that the BOCs' special access provisioning is inferior. For example, the Minnesota PUC, after reviewing a complaint filed by AT&T, concluded that there was a:

> clear need for further investigation, careful monitoring, and, potentially, wholesale access service quality standards for [Qwest, because] ensuring reliable, high quality long distance service between all Minnesota households and businesses is one of this Commission's highest priorities. The record in this case raises the serious possibility that the quality of [Qwest's] wholesale access services may jeopardize this important goal.[100]

Likewise, in another state complaint case, the Colorado Public Utilities Commission found serious problems with special access provisioning:

> AT&T has experienced regular, frequent, widespread, and ongoing delays in obtaining access . . . When [Qwest] does not meet its dates for the provision of service, it works a hardship on AT&T as well as AT&T's customers . . . On a region-wide, multi-state basis, [Qwest] has provisioned DS1s and DS0s to AT&T on a wholesale basis after a longer interval than it provided those same services to other wholesale customers.[101]

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[98] *See* AT&T Audit Comments at 19-22 & Bell Decl. ¶¶ 43-44.

[99] *See* AT&T Audit Comments at 19-20 (citing Verizon Audit, Table 14a, 14b. 14c).

[100] MPUC Docket No. P-421/C-99-1183, *Complaint of AT&T Communications Of the Midwest Inc. Regarding Access Services*, 2000 Minn. PUC Lexis 53, *34 (Aug. 15, 2000).

[101] CPUC Docket No. 99F-404T, *AT&T Communications of the Mountain States, Inc. v. U S West Communications, Inc.,* Decision No. R00-128, at II.D, F, G (Feb. 7, 2000); *see also* (continued . . .)

These findings are all the more significant because publicly available data on BOC special access performance is generally inadequate -- often because the BOCs have insisted upon hiding such data from the public view. Additionally, the findings and data on special access performance collected by state commissions are limited because many of them have hesitated to assert jurisdiction over the BOCs' performance in providing special access services, which are used primarily for interstate traffic.[102] Moreover, although ILECs provide service quality data to IXCs for business purposes, such data are typically subject to confidentiality agreements that forbid IXCs from disclosing the data, or that require IXCs to seek ILEC approval before doing so. Further, although the Biennial Audit report for SBC in Texas was released on December 17, 2001, SBC redacted *all* of the performance data for special access services -- notwithstanding the Commission's express holding that public comment on such data is a "critical component[] in ensuring compliance with the separate affiliate safeguards and promoting competition in the market for in-region interLATA telecommunications."[103]

In fact, the performance data SBC sought to keep secret showed that SBC's affiliates received better performance in *each* of the last seven months audited -- and the largest differences were in the last two months reported, confirming that SBC's performance was decreasing.[104] The data also show that SBC's return of firm order confirmations on DS1 and DS3 facilities were longer for SBC's rivals than for its affiliates in *all* 18 of the instances where

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Comments of Texas Public Utility Commission, CC Dockets 96-98, 98-147, 01-337, at 5 (filed March 18, 2002) (noting its investigation of SBC's provision of special access).

[102] *See* AT&T Special Access Comments at 21.

[103] Memorandum Opinion and Order, *Accounting Safeguards under the Telecommunications Act of 1996: Section 272(D) Biennial Audit Procedures,* 17 FCC Rcd. 1374, ¶ 12 (2002)

[104] *See* Comments of AT&T Corp at 17-25, CC Docket No. 96-150 (filed Jan. 29, 2003).

the measure employed showed a performance difference. Likewise, SBC's competitors virtually always suffered longer delays for restoration of trouble than SBC's affiliates.[105]

Despite the BOCs' efforts to suppress data regarding their special access performance, AT&T has submitted testimony to the Commission that, on a national, aggregated basis, tracked performance trends for special access over the last five years.[106] That analysis demonstrated that ILECs consistently failed to provision DS-1 orders in a timely manner -- in the five years AT&T examined, the ILECs' failure rate was as high as 23 percent, and it never fell below 10 percent.[107] Moreover, the data reflected a *downward* trend in on-time performance. And AT&T's national data also showed that ILECs failed to respond to outages in a timely fashion.[108]

"Growth" Discounts. The BOCs have also used their market power to discriminate against rivals and in favor their affiliates in rates for switched access services. The Commission has already given special attention to schemes by which a BOC may be able to establish rates that appear to be facially neutral, but in fact have an unlawful, discriminatory impact. In the *Non-Accounting Safeguards Order*, the Commission recognized that "a BOC may have an incentive to offer tariffs that, while available on a nondiscriminatory basis, are in fact tailored to its affiliate's specific size, expansion plans, or other needs."[109] Similarly, the Commission elsewhere has specifically noted that "growth discounts," which offer reduced

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[105] *Id.*

[106] *See* Declaration of Maureen Swift on Behalf of AT&T Corp. CC Docket 01-321 (Appended to AT&T's Reply Comments filed Feb. 12, 2002).

[107] *Id.* ¶¶ 10-12.

[108] *Id.* ¶ 12.

[109] *Id*. ¶ 257.

prices based on growth in traffic, "create an artificial advantage for BOC long distance affiliates with no subscribers, relative to existing IXCs and other new entrants."[110]

The Commission has also recognized that BOC affiliates, which "will begin with existing relationships with end users, name recognition, and no subscribers," will be able to "grow much more quickly than existing IXCs and other new entrants."[111] It has further recognized that "incumbent LECs could circumvent the nondiscrimination provisions of section 272 by offering growth discounts for which, as a practical matter, only their affiliates would qualify."[112] In light of this risk, and finding that growth discounts offered "no affirmative benefit" to the development of competitive access markets, the Commission expressly prohibited the use of growth discounts in interstate switched access service tariffs.[113]

Despite this ruling, BellSouth last year filed a tariff establishing a discriminatory growth discount favoring BellSouth's long distance affiliate ("BSLD") over large, established IXCs such as AT&T.[114] BellSouth's tariff offered discounts based on percentage growth from a fixed customer base, and thus had a discriminatory impact on established IXCs because they start with a large customer base, from which it is difficult to grow annually on a high percentage basis.[115] BSLD, on the other hand, begins with a very small customer base. As BSLD enters interLATA markets, it can leverage BellSouth's monopoly customer base into a large share of

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[110] *Pricing Flexibility Order,* ¶ 134.

[111] Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry, *Access Charge Reform Price Cap Performance Review of Local Exchange Carriers,* 11 FCC Rcd. 21354, ¶ 192 (1996).

[112] *Id*.

[113] *Access Charge Reform NPRM,* ¶ 135.

[114] *See* Comments of AT&T Corp., WC Docket No. 02-150, at 47-51 (filed July 11, 2002) ("AT&T Alabama 271 Comments").

long distance markets, mostly at the expense of the large IXCs. Thus, even though AT&T's total access minutes are significantly larger than those of BSLD, BSLD would show "growth" in its initially small volumes, and on that basis obtain a larger volume discount and lower access charges than AT&T and other large IXCs.[116]

PIC Process and PIC Freezes. Vital and robust competition in interLATA markets is also critically dependent upon the PIC process, the method for a customer to change its primary long distance carrier that allows IXCs to win interLATA customers in a rapid and efficient manner. Because of their dominance in local markets, BOCs retain control over the PIC process.[117] As a consequence, BOCs have obvious incentives to use the PIC change process in myriad ways to favor their long distance affiliates and customers. The BOCs, for example, not only implement PIC changes for their affiliates more quickly, but also engage in myriad additional forms of discrimination, such as routinely placing a "PIC freeze" (a process which makes it more difficult for a customer to change its local carrier) on customers that select BOC affiliates' long distance services. Even though data relating to the PIC process is even more limited than data on special access, there is substantial evidence that BOCs have manipulated that process to favor their interLATA affiliates and to discriminate against rival IXCs.

For example, a California ALJ last year determined that "a substantial possibility of harm to the intrastate long distance telephone market exists from [the BOC's] continuing role

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[115] *See* AT&T Alabama 271 Comments & King Decl. ¶ 12.

[116] *Id*. ¶ 6.

[117] *See* Second Report and Order and Further Notice of Proposed Rulemaking, *Implementation of Subscriber Carrier Selection Changes Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 1508, ¶ 116 (1998).

as the [PIC] administrator."[118] The ALJ recognized that there is a "tension between Pacific's duty to administer PIC changes in a competitively neutral way and its interest in winning customers."[119] The ALJ found that Pacific Bell "failed to offer any assurance that it would perform its [PIC administrative] role with any safeguards of neutrality or sensitivity to competitor concerns."[120] In doing so, the Judge relied on a partial audit that found "problems with a significant percentage of" disputed PIC changes administered by Pacific. Accordingly, the California ALJ concluded that, unless PIC changes were handled by a neutral administrator, "there is a substantial possibility that the intrastate interexchange telecommunications market will be harmed through increasing customer dissatisfaction and carrier conflicts."[121]

In Colorado, Qwest unilaterally extended PIC freezes the day that intraLATA presubscription was implemented -- the first time that customers were able to choose their intraLATA carrier. By extending the freeze to the intraLATA carrier, Qwest froze *itself* as virtually all customers' carrier, thus impeding customers' ability to choose a carrier other than Qwest. Qwest rejected thousands of customers' orders to switch away from Qwest. AT&T and other carriers were forced to file complaints regarding Qwest's action, and an ALJ found that the institution of the freeze was unlawful.[122] The ALJ found that Qwest "used its position as the sole 1+ intraLATA provider in its extensive service area to inhibit the entry of competitors into the

[118] *California ALJ Decision,* at 245.

[119] *Id.* at 247-248.

[120] *Id.* at 288.

[121] *Id.* at 300.

[122] *Before the Public Utilities Commission of the State of Colorado,* Docket No. 99K-193T, Decision No. C00-301, March 22, 2000.

intraLATA market and tangibly damaged the entering competitors," and that Qwest's "abuse of its market position to inhibit and damage competition was anticompetitive." [123]

The BOCs have also caused significant harm to interLATA markets by manipulating the PIC freeze process. In particular, AT&T and other IXCs have provided evidence that Verizon persistently abused its ability to discriminate in the administration of the PIC freeze process to advantage its own toll services and disadvantage its New York competitors.[124] For example, IXCs have shown that Verizon (i) imposed PIC freezes on its own toll accounts without customer consent (thus making it more difficult for rivals to switch over customers they win from Verizon), (ii) disrupted the three-way calls that are typically used to lift PIC freezes, and (iii) gave preferential treatment to customers who were selecting Verizon long distance, but who had PIC freezes on their toll lines.[125] In addition, AT&T's evidence to the New York PSC demonstrated that Verizon personnel would often simply ignore or override a customer's valid PIC freeze when seeking to convert that customer to Verizon long distance.[126]

This problem does not disappear with section 271 approval or the passage of time. The Verizon biennial audit collected information regarding Verizon's processing of PIC changes. Even though the audit examined only a single aspect of that process, the data collected in the audit provided significant evidence of discrimination: in all five months covered by the audit, it took substantially longer for Verizon to implement competitors' PIC changes than those

[123] *Id.* at 10.

[124] *See* Letter of Harry M. Davidow, AT&T, to Hon. Janet H. Deixler, New York, P.S.C., Cases No. 00-C-0897 et al (Jan. 18, 2002).

[125] *Id.* at 2.

[126] *Id.* at 4.

of Verizon's affiliates.[127] In one month, for example, it took Verizon over three times as long to process competitors' PIC changes.[128]

4. BOCs Have Engaged in Cost Misallocations That Distort Competition in InterLATA Markets.

BOC market power over local exchange and exchange access also provides them with the ability to allocate costs and otherwise structure their local operations in a manner that favors the BOCs' own long distance operations and harms those of competitors.[129] The *LEC Classification Order* recognized that "improper allocation of costs by a BOC is of concern because such action may allow a BOC to recover costs from subscribers to its regulated services that were incurred by its interLATA affiliate in providing competitive interLATA services."[130] The Commission further recognized that "[I]n addition to the direct harm to regulated ratepayers, this practice can distort price signals in [competitive interLATA service] markets and may, under certain circumstances, give the affiliate an unfair advantage over its competitors."[131]

As Dr. Selwyn describes, the BOCs have in fact misallocated costs in this way, and have thus used their local service bottlenecks to cross-subsidize competitive interLATA services even while they have been subject to the section 272 safeguards Congress established specifically to prevent such anticompetitive misconduct.[132] For example, by virtue of the

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[127] AT&T Audit Comments at 18 n.11, 19-20 & Bell Dec. ¶ 45.

[128] BOC "tying" arrangements between local and intraLATA toll services further demonstrate how local bottlenecks may be leveraged into long distance markets. *See* Selwyn Dec ¶¶ 71-72.

[129] *See Verizon*, 122 S. Ct. at 1662.

[130] *LEC Classification Order*, ¶ 103, citing *Non-Accounting Safeguards NPRM*, ¶ 135.

[131] *Id*.

[132] Selwyn Dec., ¶¶ 58-70. *See also, LEC Classification Order*, ¶ 103("Recognizing this concern, Congress established safeguards in section 272, which we have implemented in the *Non-Accounting Safeguards Order* and *Accounting Safeguards Order*.")

BOCs' monopoly status, they acquired a massive customer base as well as ready access to a steady stream of inbound, customer-initiated contacts.[133] As a 2002 audit report in California described, BOCs such as Pacific Bell have over many years developed extensive and massive customer databases, which contain substantial and valuable customer information, including customer names, addresses, and phone numbers, as well as "detailed historical information concerning customer telecommunications services and credit."[134] The BOCs have used these advantages to provide marketing services and assets to their interLATA affiliates at reduced costs or even free of charge.

As the California ALJ described in crediting a competing carrier's testimony regarding a proposed BOC marketing plan, the BOC long distance affiliate, "through its position as the incumbent, . . . obtains marketing access to millions of potential interLATA customers at a cost that is far below either the cost to the RBOC to produce the joint marketing services, or the fair market value of the service."[135] The ALJ cited to evidence showing that, although the fair market value of new customer acquisition ranged from about $300 to $500 per sale, the BOC long distance affiliate was paying the BOC a mere $3.54 per sale.[136] The ALJ determined that the BOC's "proposed joint marketing plan clearly demonstrates cross-subsidization, and we find it very troubling" -- in particular because of the "economic detriment [to] the local ratepayers."[137] The ALJ concluded that the BOC needed to "re-examine" its plans, and warned

[133] Selwyn Dec., ¶¶ 52-53, 55.

[134] Supplemental Report, Regulatory Audit of Pacific Bell for the Years 1997, 1998, and 1999 at S12-4, S12-6 (prepared for the Cal. PUC by Overland Consulting, dated June 20, 2002) ("*Overland Supp. Cal. Audit*").

[135] *California ALJ Decision* at 251-52.

[136] *Id.* at 252 n.376.

[137] *Id.* at 252.

that, if cost misallocation was later uncovered in the final plans, "we will not hesitate to take the strongest action."[138]

In addition to marketing services, BOCs also apparently provide their interLATA affiliates with free access to the valuable BOC customer databases. The 2002 audit of Pacific Bell discovered that "SBC began transferring Pacific Bell's customer service, marketing, and sales functions to SBC Operations, a corporate shared services affiliate."[139] The transfers also include "Pacific Bell's customer database," but the auditors determined that "Pacific Bell has not been compensated for the transfer."[140] That is entirely unjustified, because the auditors noted that the data could "be used for a variety of purposes by a wide range of subsidiaries" -- including SBC's long distance affiliates.[141] The auditors found that "the most obvious benefit provided by access" to the database is "sales leads," but other benefits included the ability to develop "marketing strategies" and to "piggyback" on the database in order to "maintain an ongoing picture of their relations between their customer and their service base."[142] Given the "evident" and "definable benefits," and other "advantages that inure to affiliates with access to a complete local exchange . . . database," the auditors concluded that the value of the access to the

[138] *Id.* at 253.

[139] *Overland Supp. Cal. Audit* at S12-1.

[140] *Id.* The auditors requested information from Pacific about the transfer in June, 2001, but did not receive responses for about 9 months – which is why a supplemental report was required. *Id.* at S12-1 to S12-2. The responses indicated that Pacific Bell was compensated only for the customer service labor in providing marketing services and for sales referrals, which generated about $8 million annually for Pacific Bell (*id.*) – an unconscionably low number given the market rate for referrals and the fact that other intangible assets (such as the rights to the SBC corporate name) were billed at much higher rates. *See id.* at S12-7.

[141] *Id.* at S12-7; S12-1.

[142] *Id.* at S12-4, S12-7.

database was "worth at least as much" as $400 million, the amount Pacific Bell paid SBC for the rights to the SBC corporate name.[143]

In addition, as shown by Dr. Selwyn, even while subject to the section 272 affiliate transaction rules designed to prevent cost misallocation, SBC and Verizon have structured the pricing of their billing and collection services with discounts for which only their own long distance affiliates are likely to qualify because they require a commitment of 85 percent of a carrier's in-region billing to the BOC regardless of actual volumes.[144]

Accordingly, there is overwhelming evidence of BOC anticompetitive conduct following the grant of section 271 relief, notwithstanding Commission predictions that safeguards other than dominant carrier regulation of BOC long distance affiliates would adequately address such conduct. Moreover, as consumers increasingly purchase bundled long distance and local services, the adverse effects of such anticompetitive conduct extend beyond long distance markets. As the *LEC Classification Order* further noted, "degrading a rival's interexchange service may also undermine the attractiveness of the rival's interexchange/local exchange package and thereby strengthen the BOC's dominant position in the provision of local exchange services."[145]

III. DOMINANT CARRIER REGULATION IS ESPECIALLY CRITICAL IF BOCS PROVIDE LOCAL AND LONG DISTANCE SERVICES ON AN INTEGRATED BASIS

By providing local and long distance services through a single entity, the BOCs are able to engage in price squeezes, cost misallocation and discrimination with much less risk of

[143] *Id.* at S12-5, S12-7.

[144] Selwyn Dec., ¶ 66.

[145] *LEC Classification Order*, ¶ 111.

detection and could rapidly leverage their local bottlenecks to remonopolize long distance markets. To limit such misconduct, the BOCs should be regulated as dominant carriers following any sunset of section 272.

Because of their market power over virtually all exchange and exchange access services, "incumbent local exchange carriers are generally treated as dominant carriers," and the dominant carrier classification applies to all of their services "absent a specific finding to the contrary for a particular market."[146] As the Commission acknowledged in the *LEC Classification Order*, dominant carrier regulation limits the ability of dominant carriers to raise rivals' costs and engage in other anticompetitive conduct. Moreover, as described in Section IV below, the present nondominant treatment of BOC long distance affiliates was predicated on other regulatory safeguards that would not be available to prevent such misconduct after sunset of section 272. Accordingly, until the Commission adopts all of the reforms necessary to prevent BOC price and non-price discrimination through abuse of their local bottlenecks, dominant carrier regulation is required.

1. Dominant Carrier Regulation is Necessary to Deter and Detect the Abuse of BOC Market Power.

BOC provision of local and long distance services on an integrated basis following any sunset of 271 would allow them to make much greater use of their access cost advantage and entrenched local service monopoly to favor their long distance services with little near-term risk of detection. As described by Dr. Selwyn, the BOCs seek "to operate their competitive businesses *incrementally* with respect to their core monopoly local service business" and "[u]nder this theory the captive local service customer pays the entire cost of all

jointly-used network facilities and organizational resources."[147] Because no CLEC will have a comparable share of the local service business in any BOC region for many years to come, if ever, even IXCs that are also CLECs cannot compete on a level footing with BOCs that use their local service bottleneck to cross-subsidize their long distance services in this way.

The Communications Act requires the elimination of such market power abuses. The Act requires that "[a]ll charges, practices, classifications and regulations for and in connection with . . . communications service . . . shall be just and reasonable."[148] Any charge, practice, classification or regulation that is "unjust or unreasonable is . . . unlawful."[149] The Commission's dominant carrier regulations consist of tariffing and related filing requirements that help enforce §§ 201-202 of the Act.[150] As the Supreme Court has stated, "[t]he tariff-filing requirement is . . . the heart of the common-carrier section of the Communications Act."[151] Where market power is absent, competitive forces generally ensure enforcement of the central common carrier goal of just, reasonable and nondiscriminatory rates. Where market power exists, however, without the transparency provided by the tariffing requirement, "[t]he

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[146] *See* Notice of Proposed Rulemaking, *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services,* 16 FCC Rcd. 22745, ¶ 5 (2001)..

[147] Selwyn Dec., ¶ 91.

[148] 47 U.S.C. § 201(b).

[149] *Id.*

[150] *See id.*, §§ 61.31 *et seq*. *See also,* First Report And Order and Further Notice of Proposed Rulemaking *Promotion of Competitive Networks in Local Telecommunications Markets, et al.*, , 15 FCC Rcd 22983, ¶ 134 (2000) ("It is well established that the Commission has broad authority to regulate the practices of LECs in connection with their provision of interstate communications services. In addition to the general authority specified in Title I of the Communications Act, Title II [and in particular §§ 201 and 202] provides a specific, substantive framework for the Commission's regulation of such practices.").

[151] *MCI Telecommunications* v. *AT&T*, 114 S. Ct. 2223, at 2225 (1994).

provisions allowing customers and competitors to challenge rates as unreasonable or as discriminatory would not be susceptible of effective enforcement."[152]

For that reason, dominant carriers are required to file tariffs that disclose not only the carriers' rates (and other terms and conditions of service),[153] but also supporting data,[154] including when rates are changed, and supporting "economic information."[155] By providing notice (ranging from a minimum of one day's notice for new services of price cap LECs to fifteen days' notice for rate increases to existing services),[156] a tariff "allows both the FCC and affected customers to review and challenge price changes."[157] When the Commission determines that a tariff does not sufficiently show that the rates and charges contained therein are "just and reasonable," the Commission may reject the tariff and order refunds.[158] Perhaps most critically, however, the tariff requirement may deter some market power abuses in the first instance, because the transparency that tariffing provides makes it more likely that misconduct

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[152] *Id*. at 2231; *see also AT&T* v. *Central Office Tel*., 118 S. Ct. 1956, at 1962 (1998) (concluding that tariffs are required in order to "prevent[ ] unreasonable and discriminatory charges").

[153] 47 U.S.C. § 203(a); 47 CFR. § 61.33.;

[154] *See generally* 47 C.F.R. § 61.38.

[155] *Id*.

[156] *See* 47 C.F.R. § 61.58.

[157] *WorldCom, Inc.* v. *FCC*, 238 F.3d 449, 454 (D.C. Cir. 2001).

[158] *See*, *e.g.*, *Southwestern Bell Tel. Co.* v. *FCC*, 138 F.3d 746, 752 (8th Cir. 1998) (affirming Commission decision to reject LEC tariffs that failed to justify their costs). At the same time, the Commission has acted to reduce the costs of tariffing by, for example, permitting electronic filing. *See*, *e.g.*, *1998 Biennial Regulatory Review – Part 61 of the Commission's Rules & Related Tariffing Requirements*, Report and Order and First Order on Reconsideration, 14 FCC Rcd. 12293, ¶¶ 5-6 (1999). Thus, tariffing is an increasingly efficient way for the Commission to ensure that it, and all interested parties, can test the reasonableness of dominant firms' rates and charges.

will be detected and punished.[159] The Commission has affirmed that such prior notice of changes in rates and service offerings "is necessary particularly in markets where there is a dominant service provider because it permits consumers or the Commission to challenge potentially unlawful rates before they become effective."[160]

As described by Dr. Selwyn, dominant carrier tariff filing and cost support requirements protect against price squeeze conduct by ensuring that rates are supported by all relevant costs, including both access and non-access costs, such as sales and marketing, billing and collection, uncollectibles, customer care, and other network costs.[161] In this regard, the application of the non-sun setting section 272(e)(3) access imputation requirement alone could not prevent below-cost pricing, because, as noted by Dr. Selwyn, non-access costs indisputably are greater than zero, and therefore "the presence of any non-access costs would place rival IXCs in a price squeeze if the BOC's retail price fails to cover such non-access costs."[162] Accordingly, section 272(e)(3) does not "provide adequate safeguards to deter anticompetitive behavior." Notice, ¶ 46. Dominant carrier regulation, unlike the section 272(e)(3) imputation requirement, ensures that a BOC's prices cover *all* relevant costs, including both *access* costs and *non-access* costs.

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[159] *See* Selwyn Dec. ¶¶ 6-8. Currently, the Commission's maximum penalties are not adequately severe, and the ILECs view them as a mere cost of doing business. AT&T addresses this issue in more depth in other ongoing proceedings. *See Performance Measurements and Standards for Interstate Special Access Services*, CC Docket No. 01-321 (Jan. 22, 2002); *Performance Measurements and Standards for Unbundled Network Elements and Interconnection*, CC Docket No. 01-318 (Jan. 22, 2002).

[160] *Comsat Corp*., 13 FCC Rcd. 14083, ¶ 153 (1998).

[161] Selwyn Dec., ¶¶ 77-78, 88, 93, 102.

[162] *Id*., ¶ 88.

Critically, however, BOC compliance with dominant carrier cost support requirements for access should be based upon the imputed access cost required by section 272(e)(3). If the BOCs were allowed to comply with dominant carrier cost support requirements based on the economic cost of access to a BOC, while unaffiliated IXCs continued to pay above-cost access rates, the BOCs would still be able to make anticompetitive use of their access cost advantage to price squeeze rival carriers. As described below, section 272(e)(3) remains a necessary safeguard, and should be used to determine BOC compliance with dominant carrier rules, for as long as IXCs must pay access rates that are above the access costs incurred by ILECs in providing their own long distance services.

Thus, the Commission also should adopt rules to ensure compliance with section 272(e)(3) by requiring the BOCs to impute access costs for each identifiable service offering, including each component in a bundled offering of multiple services.[163] As noted by Dr. Selwyn, the BOCs frequently attempt to satisfy such requirements across the aggregate of their long distance services, thus using high margin services such as operator assisted calls to subsidize discounted toll plans that, by themselves, would fail imputation.[164] *Service by service* imputation requirements are necessary to prevent such anticompetitive cross-subsidization.[165]

Dominant carrier regulation is also necessary to prevent cost misallocation. As described by Dr. Selwyn, "the presence of substantial joint costs raises the spectre of serious

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[163] *Id*., ¶ 92.

[164] *Id*., ¶¶ 76, 89.

[165] Similarly, the BOCs should not be allowed to avoid the imputation safeguard by using different access facilities from those provided to competing IXCs and imputing the cost of those different facilities rather than the facilities used by IXCs. The relevant access costs for imputation should be those paid by unaffiliated IXCs, irrespective of any different facility arrangements that may be used by the BOC. *See id*. ¶ 112.

misallocation of those costs."[166] Notably, "[w]ithout dominant carrier regulation and full tariff and cost reviews, there is little practical means even to identify, let alone correct, efforts by the then-integrated BOCs to assign as much of these joint costs to their regulated operations as possible or to shift joint costs out of competitive services and over to monopoly services so as to support discriminatory pricing of their competitive services."[167] Therefore, the dominant carrier tariff review process should also address "the manner in which the joint costs of functions supporting both the BOCs' local and long distance services are allocated as between these two categories."[168]

The Commission recognized in the *LEC Classification Order* that "certain aspects of dominant carrier regulation might constrain a BOC's ability to raise the costs of its affiliate's interLATA rivals or engage in other anticompetitive conduct."[169] The Commission also noted that the tariff filing and cost support requirement "might help to detect and prevent predatory pricing" and that price cap regulation of long distance services could deter attempts to raise rivals' costs.[170] Similarly, the Commission has recognized that federal tariffing of advanced services enabled the Commission "successfully [to] forestall[] attempts by incumbent LECs to shift costs to monopoly services in order to justify rates that effect a price squeeze."[171]

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[166] *Id*., ¶ 93.

[167] *Id.*

[168] *Id*., ¶ 88.

[169] *LEC Classification Order*, ¶ 87.

[170] *Id. See also, id.,* n.338 (noting that "the tariff filing requirement might help detect certain types of price discrimination).

[171] Memorandum Opinion and Order, *GTE Tel. Operating Cos.,* , 13 FCC Rcd. 22466, ¶ 32 (1998); *see also* Memorandum Opinion and Order, *Bell Atlantic Tel. Cos.,* , 1998 WL 823494 (FCC), ¶ 14 (1998).

As described below, the Commission determined that BOC interLATA affiliates should be treated as nondominant in the *LEC Classification Order* based on the existence of other safeguards that no longer exist or would not apply following any sunset of section 272. In the absence of those other safeguards, the BOCs should be regulated as dominant if they provide local and long distance services through a single entity. Price squeeze conduct and misallocation of costs by BOC interLATA affiliates since 1997, and the heightened incentives to engage in such conduct if the BOCs provide local and interLATA services on an integrated basis, underscore the critical need for the dominant carrier regulation required by the BOCs' market power over local exchange and exchange access following any removal of section 272.

2. Section 208 Fails to Provide an Adequate Substitute for Dominant Carrier Regulation.

The Commission cannot reasonably rely on the section 208 complaint process to prevent BOC abuse of their local bottlenecks.[172] By the time the complaint process has run its course, the damage to competition is done. Verizon and SBC have demonstrated that BOCs may boost market share by 30 points or more during the 12-24 months it may take the Commission to address an IXC complaint.[173] Moreover, the BOCs have shown they are willing to breach and endlessly litigate enforcement of even their clearest legal obligations, as reflected in the Commission's record-setting fine last year against SBC for "willful and repeated[]" violations of SBC/Ameritech merger conditions.[174]

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[172] *See* 47 U.S.C. § 208.

[173] Selwyn Dec., ¶ 102.

[174] SBC Communications, Inc., Apparent Liability for Forfeiture, File No. EB-01-IH-0030, FCC 02-282 (rel. Oct. 9, 2002), ¶ 1. *See also, id*., ¶ 24 ("In state after state, throughout the Ameritech region, SBC forces competing carriers to expend time and resources in state proceedings trying to obtain what SBC was already obligated to offer, causing delays in the availability of shared transport.")

Accordingly, the Commission should not -- and cannot -- rely on the complaint process to remedy BOC anticompetitive abuse of their bottleneck facilities resulting from an overly-permissive regulatory scheme. The courts of appeals have held that the existence of a "safety valve" that permits a variance from a generally applicable regulatory scheme does not excuse an agency from failing to address a systemic problem inherent in the underlying regulatory scheme. For example, in *Time Warner Entertainment Co., L.P.* v. *FCC,* 56 F.3d 151 (D.C. Cir. 1995), the court of appeals considered a challenge to a provision of the Commission's rate-cap regime for cable television. The Commission failed to permit recovery of cost increases incurred in the period between the date on which the baseline rates were set and the effective date of the regulations.[175] The court rejected the Commission's attempt to justify its decision on the grounds that disadvantaged cable companies could always seek the imposition of cost-of-service ratemaking. Because that option "is costly . . . and is intended to be a limited 'safety-valve' exception," the court held that it cannot be a widely-used mechanism for correcting an imprudent rate scheme.[176]

3. U.S. Trade Commitments Require Regulatory Safeguards to Prevent Anticompetitive Practices by BOCs and ILECs.

Dominant carrier regulation or other regulatory safeguards preventing such anticompetitive practices are also required by U.S. multilateral trade obligations. The WTO commitments on basic telecommunications services made by the United States under the General Agreement on Trade in Services include the regulatory obligations contained in the

[175] *See Time Warner*, 56 F.3d at 173.

[176] *Id.*; *see also Ass'n of Oil Pipelines* v. *FERC*, 281 F.3d 239, 244 (D.C. Cir. 2002); *American Gas Ass'n* v. *FERC*, 912 F.2d 1496, 1517-18 (D.C. Cir. 1990); *ALLTEL Corp.* v. *FCC*, 838 F.2d 551, 561 (D.C. Cir. 1988).

Reference Paper.[177] Section 1 of the Reference Paper requires the United States to maintain "[a]ppropriate measures . . . for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices."[178] Anticompetitive practices "include in particular . . . engaging in anticompetitive cross-subsidization."[179] A "major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services" resulting from either "control over essential facilities" or "use of its position in the market."[180]

The Commission has acknowledged that "Section 1 of the Reference Paper . . . requires us to maintain measures that would prohibit anticompetitive activity of suppliers, which alone or together, constitute a 'major supplier.'"[181] The Commission has further emphasized that "the Reference Paper explicitly imposes an obligation on WTO Members which adopted it to take actions to prohibit anticompetitive behavior."[182] In fact, the United States has brought a WTO Dispute Settlement Body complaint against Mexico alleging, among other things, that the Government of Mexico has failed to comply with its obligations under

[177] United States, Schedule of Specific Commitments, World Trade Organization, Fourth Protocol to the General Agreement on Trade in Services, GATS/SC/90/Suppl.2, Apr. 15, 1997, at 4-6.

[178] *Id*. at 4. *See also, Foreign Participation Order*, ¶ 340.

[179] United States, Schedule of Specific Commitments, World Trade Organization, Fourth Protocol to the General Agreement on Trade in Services, GATS/SC/90/Suppl.2, Apr. 15, 1997, at 4.

[180] *Id. See also, Foreign Participation Order*, ¶ 340, n.693.

[181] *Id*., ¶ 358.

[182] *Id*., ¶ 372.

section 1 of the Reference Paper.[183] The Commission also has affirmed that its Section 63.10 dominant carrier rules for U.S. affiliates of carriers with market power at the foreign end of U.S. international routes "are designed to do exactly that – deter anticompetitive behavior by carriers that, alone or together, control 'essential facilities or otherwise have the ability to affect the market adversely.'"[184]

Because the ILECs also control essential facilities and thus have the ability to affect the market adversely, the Commission is required by the Reference Paper to maintain measures to prevent the ILECs "from engaging in or continuing anti-competitive practices." As described above, BOC and ILEC control of upstream essential facilities is no different from the control of upstream essential facilities by the U.S. affiliates of carriers with market power in foreign markets. The ILECs, therefore, indisputably are also "major suppliers" under the Reference Paper. Moreover, the many U.S. affiliates of foreign carriers from WTO Member countries that have entered the U.S. market in recent years require access to the ILEC local bottlenecks to originate and terminate services in the U.S. market and are adversely affected by ILEC anticompetitive practices.[185]

Thus, in the absence of the regulatory basis for the nondominant treatment adopted in the *LEC Classification Order*, the Commission is required by U.S. WTO

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[183] *See* Letter, dated Feb. 13, 2002, to H.E. Mr. Kare Bryn, Chairman, Dispute Settlement Body, World Trade Organization, from Ambassador Linnet F. Deily, Office of the United States Trade Representative.

[184] *Id*., ¶ 372.

[185] *See, e.g.*, Comments of Cable & Wireless USA, Inc., RM Docket No. 10593, Dec. 2, 2002, at 7 (noting that "Cable & Wireless remains a captive customer of the BOCs with respect to the vast majority of the buildings Cable & Wireless must reach to provide its own customers with innovative IP-based services"); *id.* at 8 ("the Commission's own World Trade Organization ("WTO") commitments compel Commission action to reform special access rates.")

commitments to take affirmative measures to prevent ILEC abuse of the market power conferred by their local bottlenecks.

IV. CHANGED CIRCUMSTANCES REQUIRE A DIFFERENT APPROACH FROM THAT TAKEN BY THE *LEC CLASSIFICATION ORDER*.

The key predicates for according nondominant treatment to the BOC long distance affiliates in the *LEC Classification Order* would no longer apply after any sunset of section 272. As a result, the Commission is obliged to take these and other changed circumstances into account in making its decision here.

The Notice acknowledges (¶ 7) that the Commission's existing non-dominant treatment of BOC long-distance affiliates was "*predicated* on the presence of a section 272 separate affiliate and full compliance with the structural, transactional and nondiscrimination requirements of section 272 and the Commission's implementing rules."[186] By definition, those safeguards, except for two provisions of section 272(e), would not be available to prevent the BOCs' abuse of market power in circumstances addressed by this proceeding, *i.e.*, "after sunset of the Commission's section 272 structural and related requirements in a state." Notice, ¶ 2. Other regulatory safeguards relied upon by the *LEC Classification Order*, such as price cap regulation to help prevent price squeezes from higher access prices, and the use of UNEs to avoid access charges, have also been reduced or removed since that order was issued. Moreover, the Commission's reliance on these regulatory safeguards to prevent harm to long

[186] Emphasis added. *See also*, Second Order on Reconsideration and Memorandum Opinion and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Own Local Exchange Area*, 14 FCC Rcd. 10771, ¶ 37 ("We emphasize that the classification of the BOC interLATA affiliates as non-dominant applies *only* to BOC interLATA affiliates that have satisfied the requirements of sections 271 and 272 and the other regulatory requirements relied upon in the LEC Classification Order.") (Emphasis added.)

distance competition from BOC market power over the local bottleneck was itself misplaced, as demonstrated by the subsequent BOC anticompetitive misconduct described above.[187]

Changes in the marketplace since the Commission's 1997 decision, which long predated any grant of section 271 relief, militate against application of nondominant treatment. While the intervening years have brought no meaningful change in the BOC control of the local exchange and exchange access bottleneck, BOCs have now received 271 authority in 42 states and the District of Columbia, and have shown that they can rapidly obtain long-distance market shares over 50 percent even with section 272 separation requirements. BOC competitors are greatly diminished in number, weakened in financial strength, and less able than the BOCs to provide the bundled local, long distance, DSL and wireless services for which there is increasing consumer demand. Actual market developments thus provide no substitute for the regulatory safeguards the Commission previously relied upon to prevent BOCs from abusing their local bottlenecks.

Under well-established D.C. Circuit precedents, the Commission is required to conform its former predictive judgment -- that the existence of other safeguards allowed BOC interexchange affiliates to be regulated as nondominant -- to reflect these significantly changed circumstances. It is "settled law that an agency may be forced to reexamine its approach if a significant factual predicate of a prior decision . . . has been removed."[188] An agency has a bedrock obligation to ensure that current facts support its ongoing policy.[189] That duty is also

[187] *See also*, Selwyn Dec., ¶¶ 58 et seq..

[188] *Bechtel* v. *FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992)

[189] *See, e.g., National Broadcasting Co.* v. *United States*, 63 S. Ct. 997, 1014 (1943) ("If time and changing circumstances reveal that the 'public interest' is not served by application of the Regulations, it must be assumed that the Commission will act in accordance with its statutory obligations").

heightened where, as here, the prior decision was based on predictive judgments that in turn were based on the existence of other regulatory safeguards that the Commission has subsequently permitted to lapse. "The Commission's necessarily wide latitude to make policy based on its predictive judgments deriving from its general expertise implies a correlative duty to evaluate its policies over time to ascertain whether they work – that is, whether they actually produce the benefits the Commission originally predicted they would."[190]

The Commission itself has acknowledged this obligation.[191] And to the extent that the adoption of different regulatory measures reflecting changed circumstances would arguably entail a "change of mind" by the Commission, such a change does not remotely "render the agency's action arbitrary."[192]

1. The Commission's Prior Nondominant Regulation of BOC Interexchange Affiliates Placed Critical Reliance Upon Section 272.

Although the Commission recognized in the *LEC Classification Order* that dominant regulation could prevent BOC abuse of market power,[193] it declined to regulate the BOC interexchange affiliates as dominant for this reason, because it concluded that "we believe that *other regulations* applicable to the BOCs and their interLATA affiliates will address the

[190] *Bechtel* v. *FCC*, 957 F.2d at 881 (internal citation omitted).

[191] *See, e.g.,* Notice of Proposed Rulemaking, *Reexamination of the Policy Statement on Competitive Broadcast Hearings*, 7 FCC Rcd. 2664, ¶ 4 (1992); *Amendment of the Commission's Rules to Establish Part 27*, Report and Order, 12 FCC Rcd 3977, ¶ 27 (1997) (policy based on "realistic assumptions" which, if shown not to be accurate in practice, "we would of course revisit this issue and make appropriate adjustments").

[192] *Bell Atl. Tel. Cos.* v. *FCC,* 79 F.3d 1195, 1202 (D.C. Cir. 1996). *See also, AFL-CIO* v. *Brock*, 835 F.2d 912, 916-17 (D.C. Cir. 1987) ("courts recognize that agencies must respond to changed circumstances to carry out Congress' purposes")

[193] *LEC Classification Order*, ¶ 87.

anticompetitive concerns raised in the Notice in a less burdensome manner."[194] In particular, the Commission relied on the fact that the BOCs' affiliates were required by section 272 to be "structurally separate" from the BOCs and to "operate independently" from the BOCs.[195]

However, significant aspects of those "other regulations" cited by the Commission will no longer apply. By definition, section 272 requirements would no longer apply after any sunset of that provision. And, as shown above, the *Pricing Flexibility Order* has removed price cap protection and enabled the BOCs to use increased special access rates to price squeeze their rivals. Thus, the principal safeguards the Commission previously relied upon to prevent the BOCs from "us[ing] their market power in local exchange and exchange access services to engage in anticompetitive conduct in competitive markets" would be absent.[196] Given these different circumstances, different safeguards are necessary to prevent BOCs from using their local bottleneck anticompetitively.

Similarly, the *LEC Classification Order* also considered "whether [the BOCs] can use [market power in the provision of local exchange and exchange access services] to give their interLATA affiliates the ability to raise the prices of in-region, interstate, domestic interLATA services by restricting their own output of those services."[197] The Commission's finding that the BOCs would not be able to leverage their local exchange and exchange access market power in this way was also substantially based on the existence of section 272.

Specifically, the Commission relied extensively on the existence of the structural safeguards, audit requirements and affiliate transaction requirements of section 272 to support

[194] *Id.*, ¶ 91 (emphasis added).

[195] *Id.* ¶ 91, 112-18.

[196] *LEC Classification Order*, ¶ 91.

its finding that "applicable statutory and regulatory safeguards are likely to be sufficient" to prevent the BOCs from eliminating competing IXCs by engaging in improper cost misallocation.[198] The Commission also found that concerns that the BOCs would harm rivals by "exploiting improper cost allocation to divert business to BOC interLATA affiliates from other, more efficient suppliers," even if those rivals were not driven from the market, were "best addressed through enforcement of the section 272 requirements."[199] Further, in finding that "statutory and regulatory safeguards" would prevent a BOC from engaging in discrimination that would allow it to raise interexchange prices by restricting its own output, the Commission substantially relied on section 272 nondiscrimination and structural separation requirements.[200] The Commission also relied on the section 272 biennial audit requirement to help address predatory price squeeze behavior.[201]

Thus, the existence of section 272 was both central and essential to the Commission's 1997 findings that the BOC interLATA affiliates would not be able to abuse their local bottlenecks to raise their rivals' costs or to allow the BOC interLATA affiliate to raise its own prices by restricting its own output. Any sunset of section 272 requirements would eviscerate the basis for granting nondominant treatment to BOC long distance entities.

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[197] *Id.*, ¶ 100.

[198] *Id.*, ¶¶ 103-05.

[199] *Id.*, ¶ 108. The D.C. Circuit has recently emphasized that anticompetitive conduct may harm the public interest even where competing carriers are not driven from the market. *WorldCom, Inc. v. FCC*, 308 F 3d 1, 10 (D.C. Cir. 2002).

[200] *Id.*, ¶¶ 111-119. As discussed above, the requirements of section 272(e)(3) would not be removed but are insufficient to prevent below-cost pricing without dominant carrier cost support requirements to ensure that BOC prices also cover non-access costs. Similarly, as described below, new performance measures are necessary to prevent the non-price discrimination addressed by section 272(e)(1).

Other regulatory safeguards cited in support of those *LEC Classification Order* findings have already been removed or shown to be ineffective in preventing BOC bottleneck abuse. As shown above, the *Pricing Flexibility Order* means that price cap regulation cannot "sufficiently constrain[]" a BOC's ability to raise special access prices so that "the BOC affiliate would gain, upon entry or soon thereafter, the ability to raise prices of interLATA services above competitive levels by restricting its own output of those services."[202] Price cap regulation also does not prevent cost misallocation. Dr. Selwyn shows that, contrary to the *LEC Classification Order,* price cap regulation in fact has not prevented the cross-subsidization of competitive services, particularly where cost and earnings reporting is reduced as part of the shift to incentive-based regulation.[203]

Similarly, another safeguard against price squeezes relied upon by the *LEC Classification Order* -- "the ability of competing carriers to acquire access through the purchase of unbundled network elements"[204] -- has been largely eliminated by subsequent Commission findings that IXCs may only use UNEs for long distance access to their *own local* customers.[205] Consequently, the availability of UNEs does not enable IXCs to avoid most ILEC access charges or reduce the BOCs' ability to use access charges to price squeeze their rivals. *See*

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[201] *Id*., ¶ 128.

[202] *LEC Classification Order*, ¶ 126.

[203] Selwyn Dec., ¶¶ 97-102; *LEC Classification Order*, ¶ 106.

[204] *LEC Classification Order*, ¶ 126. *See also*, *id*., ¶ 130 ("As noted, we believe that the ability of competing carriers to acquire access through the purchase of unbundled elements enables them to avoid originating access charges, and thus partially protect themselves against a price squeeze").

[205] Supplemental Order, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 15 FCC Rcd. 1760, ¶ 2, (1999). (*"Local Competition Supplemental Order"*)

Notice, ¶ 30. Similarly, the use restrictions and ban on commingling that applies to pre-existing combinations of unbundled loops and transport prevents competitors from converting BOCs' special access circuits to UNEs priced at cost-based rates.[206]

2. Market Developments Assist BOC's Ability to Abuse Their Market Power.

Changes in interLATA markets since 1997 also provide the BOCs with greater ability to exercise market power. The BOCs now have section 271 authority in 42 states and the District of Columbia, and have shown that they can rapidly expand beyond the "zero market share[s]" cited by the *LEC Classification Order* following the grant of section 271 relief.[207] Subsequent experience has clearly demonstrated that the 1997 order was correct that initial low market shares were "not conclusive" in determining whether dominant classification was required for BOC interLATA affiliates because they "potentially could gain significant market share upon entry or shortly thereafter" as the result of "brand identification with in-region customers, possible efficiencies of integration, and the BOC's ability potentially to raise the costs of its affilate's interLATA rivals."[208]

Verizon reported a 20 percent percent long distance market share in New York within twelve months of 271 relief, and a 34.2 percent share at the end of 2001, after just two years of offering long distance.[209] Verizon also reported a more than 20 percent share in Massachusetts after nine months.[210] SBC gained a 21 percent share in Texas within nine months

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[206] *Local Competition Supplemental Order*; Supplemental Order Clarification, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 15 FCC Rcd. 9587 (2000). *See also*, AT&T Reply Comments, (filed Jan. 23, 2003), RM No. 10593, at 51-52.

[207] *LEC Classification Order*, ¶ 96.

[208] *Id.*

[209] Selwyn Dec.**,** ¶¶34, 53.

[210] *Id.* ¶ 34.

and now claims to have market shares of "43 percent overall and about 50 percent for consumer lines" in the six states where it provides long long distance.[211] Indeed, SBC has advised investors that market shares can be expected in all its section 271 jurisdictions similar to the 60 percent market share it has obtained in Connecticut five years after SNET (which SBC has since acquired) began marketing long distance services.[212]

This BOC market share growth is unparalleled in the long distance industry -- by 1990, five years after the commencement of interLATA equal access, all non-AT&T IXCs *combined* had collectively acquired only approximately 23 percent of presubscribed lines nationwide.[213] Indeed, the 34 percent share Verizon achieved in New York after two years is *more than twice* the largest share *ever* achieved by any non-AT&T IXC.[214] As noted by Dr. Selwyn, "but for the BOCs' ability to exploit their inbound marketing channel and offer pricing plans ignoring the cost of access, here is no *a priori* reason to expect their rate of market share growth to differ materially from that of OCCs in the years following equal access."[215]

The BOCs also face financially weaker IXC competitors than in 1997. At that time, the Commission found predatory conduct by a BOC interLATA affiliate "unlikely' because "[a]t least four interexchange carriers – AT&T, MCI, Sprint, and LDDS WorldCom" had "nationwide or near nationwide networks," and were "large well-established companies

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[211] *Id*; SBC Investor Briefing, 7, http://www.sbc.com/Investor/Financial/ Earning_Info/docs/1Q_03_IB_FINAL.pdf. *See also,* Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings (contending that SBC has achieved "near 50 percent" penetration of the consumer long distance market in its Southwestern territories).

[212] Selwyn Dec., ¶ 35.

[213] *Id*., ¶ 53.

[214] *Id.*

[215] Selwyn Dec., ¶ 54.

with millions of customers."[216] Those four IXCs are now three, one of which is in bankruptcy.[217] Moreover, as described by Dr. Selwyn, "the interexchange transport cost element of end-to-end long distance service is at this point a relatively minor cost element," that is dwarfed by the other long distance costs of access charge payments to ILECs, billing and collection, advertising, marketing and customer service, and consequently "its subsequent reacquisition and reuse by another carrier (following the bankruptcy of one or more of the existing entities) is neither assured or particularly germane to the future of a competitive marketplace."[218] Accordingly, "[e]ven if a start-up long distance carrier were to obtain an in-place interexchange network essential for free, its savings on network-related transport costs would be far less than the savings that a BOC is able to realize from not having to pay itself originating access charges and the various other integration efficiencies that are available only to the BOC."[219]

The Commission also expected price squeeze risks to be "greatly reduced" by "at or near cost" interLATA access to BOC networks and "as competition develops in the provision of exchange access services."[220] However, interstate access charges remain far above cost-based levels, intrastate access charges are still many multiples of cost, and former optimism about future progress in local competition has now been shown to have been misplaced, with

[216] *LEC Classification Order*, ¶ 107. *See also, id*., ¶¶ 97, 129.

[217] Selwyn Dec., ¶ 94.

[218] Id., ¶ 95.

[219] *Id*. Thus, "because interexchange transport capacity is not a factor in limiting the supply of retail long distance service, it is extremely unlikely that any such capacity that might be released by a departing carrier would remain in use." *Id.*

[220] *Id*., ¶ 130.

many CLECs now in bankruptcy or with greatly limited operations.[221] As described above, even in the enterprise market, CLECs provide "last mile" facilities only to a small fraction of commercial buildings. Cable telephony, the primary potential last-mile facilities-based alternative for residential users, remains at *de minimis* levels in most states, as does the number of users using wireless as their only phone.

Additionally, the BOCs' ability to engage in price squeezes has increased since 1997 as a result of consolidation in the industry. The *LEC Classification Order* relied on the fact that in 1997 many long distance calls that originated on one BOC's network terminated on another BOC's network as diminishing the likelihood of a price squeeze.[222] However, the Ameritech-Pacific Telesis-SBC-SNET and Bell Atlantic-GTE-NYNEX mergers have made it much more likely that a call that originates on a particular BOC's network will terminate on that same BOC's network, thereby giving the BOC an insurmountable cost advantage with regard to *both* originating and terminating access.[223]

Other subsequent market developments also facilitate, rather than constrain, the BOCs' ability to exercise market power by leveraging their local bottlenecks. The growing popularity of bundled offerings including local and interLATA services, with unlimited calling, and of similar bundled offerings including DSL services, encourages the BOCs to exploit their local access cost advantage by engaging in prices squeezes and cost misallocation, and to discriminate in other ways.

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[221] *See, e.g.*, "FCC's Powell Says Telecom 'Crisis' May Allow A Bell To Buy WorldCom," Wall Street Journal, A1, A4, Jul. 15, 2002 (the Commission "tended to over-exaggerate how quickly and how dramatically [the local markets] would become competitive").

[222] *LEC Classification Order*, ¶ 129.

[223] *See SBC-Ameritech Merger Order*, ¶ 207 (finding merger increased incentive of SBC-Ameritech to discriminate against competitors).

A further misplaced expectation underlying the *LEC Classification Order* was that "a BOC interLATA affiliate's apparent cost advantage resulting from its avoidance of access charges may be offset by other costs it must incur, such as the cost of interLATA transport, which, at least initially, may be greater than the true marginal cost of interLATA transport for facilities-based interLATA carriers."[224] Dr. Selwyn notes that in fact the BOCs likely would enjoy "a formidable interexchange transport cost *advantage*" following any sunset of section 272, because there would then be no restrictions on their use of the interLATA facilities they were permitted to build for so-called "official" (*i.e.*, intracompany) traffic and transmission of calls to directory assistance and operator services to remotely located centralized facilities.[225] RBOC mergers have expanded the geographic scope of these networks, which were built by the regulated BOC entities with capital outlays much of which have now been recovered through rates charged to BOC monopoly ratepayers.[226]

The predictions and assumptions underlying the Commission's former classification of the BOC interLATA affiliates as nondominant -- that other regulatory safeguards and marketplace developments would prevent abuse of the BOCs' local bottleneck -- therefore provide no support for any similar finding here. Instead, the Commission must address the known, likely anticompetitive effects of the local bottleneck and adopt appropriate regulations to limit the BOCs' ability to exploit them.

IV. DOMINANT CARRIER REGULATION MUST CONTINUE UNTIL THE COMMISSION ADOPTS REFORMS PREVENTING INCUMBENT ABUSE OF LOCAL BOTTLENECKS THROUGH PRICE AND NON-PRICE DISCRIMINATION.

[224] *LEC Classification Order*, ¶ 129.

[225] Selwyn Dec., ¶ 82, n.104 (emphasis added).

[226] *Id.*

The core problem requiring dominant carrier regulation of BOCs that provide local and interLATA services on an integrated basis is their ability to leverage their local bottlenecks through price and non-price discrimination. With BOCs controlling 87 percent of local mass market customers, 97 percent of local switched access facilities, and the vast majority of last mile special access facilities, BOC market power over local exchange and exchange access will continue for many years.[227]

The BOC's ability to abuse their local bottlenecks will not be eliminated until regulatory actions (1) remove the BOCs' access cost advantage, (2) reduce BOC special access rates to just and reasonable levels, (3) establish and enforce performance measures preventing non-price discrimination, and (4) require independent PIC administration and establish greater limits on joint marketing. These essential reforms, some of which are under consideration in dockets now pending before the Commission, would not provide all the safeguards of section 272 or that would be provided by dominant carrier regulation of BOC long distance services. But once these reforms were fully carried out, they would remove the BOC access cost advantage and limit non-price discrimination, which would provide a basis to revisit the dominant carrier status of BOC interLATA services. Prior to that point, any ruling granting nondominant treatment of those services would be highly premature. Moreover, it would merely encourage the BOCs to continue to engage in anticompetitive leveraging of their local

[227] As noted above, in applying its section 63.10 dominant carrier rules and the International Settlements Policy, the Commission presumes that foreign carriers possess market power if they have market shares above 50 percent in any relevant market on the foreign end of a U.S. international route, including local access facilities. *Foreign Participation Order*, ¶ 161 & n. 312.

bottlenecks and would lead inexorably to the BOCs' remonopolization of U.S. long distance services.

1. The Need for Dominant Carrier Regulation Is Paramount Until and Unless BOC Access Cost Advantages Are Eliminated, Special Access Rates Are Reduced to Reasonable Levels, and Adequate Performance Measures and Imputation Requirements Are Adopted and Enforced.

Intercarrier Compensation Reform. There is a critical need for comprehensive intercarrier compensation reform in order to remove the BOC access cost advantage resulting from the current system of above-cost interstate and intrastate switched access rates, and to reduce the BOCs' ability and incentives to engage in anticompetitive price squeezes, and other anticompetitive cross-subsidization. Now that the BOCs have obtained section 271 authority in 42 states and the District of Columbia, IXCs should no longer be required to subsidize their BOC long distance *competitors* through above-cost switched access charges that also provide the BOCs with an unfair cost advantage in interexchange markets.

The provision of switched access to all LEC networks for all interLATA services at forward looking economic cost-based prices would create a level competitive playing field, as well as encourage efficient facilities investment and use.[228] Indeed, the Commission has long had the objective of reducing switched access charges to TELRIC levels for just this reason. However, that goal cannot be fully attained unless access charges for intrastate calls are also reduced to TELRIC levels.

The Commission could undertake such action by adopting a uniform intercarrier compensation rule requiring forward-looking, economic cost-based pricing for all minutes

[228] *See generally,* First Report and Order, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, ¶¶ 672-703 (1996).

terminated on all networks.[229] Under such an approach, all minutes would be treated identically for transport and termination purposes, whether voice or data, whatever the identity of the called party, whether the call is jurisdictionally interstate or intrastate, and whether the carriers involved are LECs or IXCs.[230] In fact, Congress intended precisely that result when it gave the Commission authority in section 251(g) to establish a reasonable transition period before bringing access charges within the cost-based reciprocal compensation standard that Congress mandated will ultimately apply to the transport and termination of all "telecommunications."[231] The adoption of such a unified approach based on forward-looking economic cost would prevent both bottleneck abuse and the regulatory arbitrage that is encouraged by the present environment.[232]

Meaningful Regulatory Constraints on BOC Special Access Services. Commission action also is required to ensure just and reasonable rates for special access, which the BOCs have raised to excessive levels and have used to create price squeezes for competitors following the *Pricing Flexibility Order*. As requested by AT&T's *Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, the Commission should, at a minimum, revoke special access pricing flexibility and reinitialize price caps to levels designed to produce normal, rather than monopoly, returns for the BOCs.[233] Additionally, to prevent further harm while the Commission conducts that rulemaking, the Commission should adopt immediate, interim relief reducing all special access charges for

[229] *See* Comments of AT&T, CC Docket No. 01-92, (filed Aug. 21, 2001).

[230] *Id*. at 9.

[231] *Id.*

[232] *Id*. at 1-3.

[233] AT&T Petition for Rulemaking (filed Oct. 15, 2002), RM No. 10593, at 39.

services subject to Phase II pricing flexibility to the rates that would produce an 11.25% rate of return (the last authorized BOC rate of return), make clear that any such rate reductions will not trigger any termination or other liability penalties, and impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking.[234] The Commission also should eliminate the use restrictions and ban on commingling that prevents competitors from converting existing special access circuits to UNEs.[235]

Performance Measures To Limit Non-Price Discrimination. A further necessary reform is the adoption of strong performance measures and standards, supported by meaningful consequences for discriminatory and unreasonable performance, to address longstanding deficiencies in the BOCs' provisioning and support of special access services.[236] The Commission should adopt the Joint Competitive Industry Group ("JCIG") Proposal under consideration in the *Performance Measurements and Standards for Interstate Special Access Services* proceeding, which is the result of an industry consensus among the entire spectrum of special access users regarding the performance measures, measurement calculations, business rules, exceptions, disaggregation levels and performance standards that are necessary to measure BOC performance in key areas.[237] A separate audit process is also necessary to ensure the reliability of performance reports.[238] As the Commission has recognized, the use of metrics is a "relatively non-intrusive means of implementing pro-competitive policies and rules and of

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[234] *Id*. at 39-40.

[235] *See* AT&T Reply Comments, (filed Jan. 23, 2003), RM No. 10593, at 51-52.

[236] *See AT&T Special Access Comments*

[237] *Id*. at 23-28.

[238] *Id.* at 29.

evaluating the incumbents' compliance with such requirements."[239] The Commission also should adopt a meaningful remedy and enforcement plan including maximally self-executing remedies to provide incentives for compliance.[240]

Independent PIC Administration. The BOC abuse of customer preferred carrier choices, changes and freezes described above amply demonstrates the need to ensure that these customer choices are administered in a competitively-neutral manner.[241] Neutral administration of these customer choices would largely eliminate the regulatory burden in resolving preferred carrier disputes (whether between carriers or between carriers and customers and for all services, including local, intraLATA, or interLATA), would facilitate regulatory monitoring of carrier behavior with real-time data while reducing the need for monitoring, and would eliminate the need for additional regulation to address slamming, cramming, BOC discrimination, and consumer frustrations related to preferred carrier freezes. Indeed, this Commission itself has taken a step toward this solution, endorsing, in its preferred carrier freeze regulations, the use of

[239] *SBC-Ameritech Merger Order* ¶ 125.

[240] *AT&T Special Access Comments,* at 36-42.

[241] In New York, the Public Service Commission in March 2001 observed that in light of Verizon having received § 271 authorization, "a more neutral system should be considered." *Order to Show Cause, Requesting Comments and Closing Cases,* Case 00-C-0897 et al., (March 23, 2001), at 23. In response, the New York Attorney General recommended that "a competitively neutral PIC freeze system be administered by an independent entity that will treat all competing providers equally." Reply Comments of Eliot Spitzer, Attorney General of the State of New York, (filed June 8, 2001), at 8. Similarly, several State public utility commissions have been considering the use of a Neutral Third Party Administrator to maintain a centralized database and/or a clearinghouse of customer-account information (such as telephone numbers, name and address, and preferred carrier freeze status for each service level) for real-time queries during sales calls and also administering all customer preferred carrier choices, changes, and freezes.

an "independent third party" to confirm requests for preferred carrier freezes.[242] The Commission accordingly should create a mechanism to ensure that the BOCs no longer dominate customers' preferred carrier choices, changes and freezes.[243]

Joint marketing. Commission action is also necessary to redress the crushing power of the joint marketing made possible by the BOCs' continuing dominance of the bottleneck and of functions related to it -- particularly joint marketing on inbound calls in which customers select a long distance provider. Both the courts and the Commission have acknowledged that BOCs may not discriminate when a customer seeks "new service," defined as "receiv[ing] service from the [particular] BOC for the first time" or "mov[ing] to another location within the BOC's in-region territory."[244] However, local customer service agents may recommend their affiliate's long distance service in such calls so long as they also mention the availability of other providers;[245] they also may market without restriction when customers call to obtain an additional line.[246]

The Commission should, at a minimum, extend nondiscrimination obligations to customer requests for a new telephone line. A customer seeking a new line is not materially

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[242] 47 C.F.R. § 64.1190(d)(2)(iii). *See also*, 47 U.S.C. § 251(e)(1) (mandating a similar approach for administering telecommunications numbering).

[243] *Notice of Inquiry Concerning a Review of the Equal Access and Nondiscrimination Obligations Applicable to Local Exchange Carriers*, CC Docket No. 02-39, Comments of AT&T, (filed May 10, 2002), at 29-39.

[244] *Non-Accounting Safeguards Order,* ¶292, fn. 761; *U.S. v. Western Electric*, 578 F.Supp 668, 676-77 (D.D.C. 1983)

[245] Memorandum Opinion and Order, *Application of BellSouth Corp., et al., Pursuant to Section 271 of the Communications Act etc.*, 13 FCC Rcd. 539, ¶¶ 231-39 (1997), *approved in AT&T Corp. v. FCC,* 220 F.3d 607, 632, (C.A.D.C. 2000)..

[246] *See* Memorandum Opinion and Order, *In the Matter of AT&T Corp.* v. *New York Tel. Co.*, 15 FCC Rcd. 19,997 (2000).

different from a customer who "receives services from the particular [BOC] for the first time" or "moves to another location within the [BOC] area." 578 F. Supp. at 677. Just as discrimination by a BOC in providing a first line can thwart interexchange competition, so also can such discrimination in providing additional lines. Requests for second (or additional) lines constitute a significant market for which BOCs should not be permitted to leverage the advantage of an "inbound channel" based upon their continuing dominance over the local telecommunications market.

2. Continuing Dominant Carrier Regulation Until Adequate Safeguards Are Developed to Limit Abuse of the Local Bottleneck is Not Unduly Burdensome.

As described above, the BOCs are properly classified as dominant carriers because of their market power in the provision of local exchange and exchange access. As such, they are not subject to the disciplines of competitive market forces and readily may leverage their market power to advantage their interLATA services by providing local and interLATA services on an integrated basis. Accordingly, following any sunset of the section 272 structural separation requirements upon which the Commission's former nondominant treatment of BOC interLATA affiliates was predicated, the Commission should require BOC compliance with dominant carrier rules ensuring that their interLATA rates are just, reasonable and nondiscriminatory, until the other safeguards necessary to prevent BOC anticompetitive leveraging of their local bottlenecks are adopted and fully implemented.

This recommended approach would fulfill the objectives stated by the Notice (¶ 40) of "minimiz[ing] regulatory burden on the BOCs" while also "avoid[ing] the potential exposure of both ratepayers in local markets and competitors in interexchange markets to the potential risk of improper cost misallocation and unlawful discrimination." And while the BOCs will no doubt contend that *any* requirement for compliance with dominant carrier rules, even for

the limited period proposed here, is "unreasonably burdensome," there is nothing unreasonable about preventing the abuse of market power.[247] Indeed, the Commission is required to take such action in the absence of adequate alternative safeguards. Because the safeguards on which the Commission's former rules on nondominant treatment of BOC interLATA affiliates were premised would no longer apply following the sunset of section 272, the "regulatory benefits" of dominant carrier regulation plainly "outweigh the burdens" pending the adoption of other reforms to prevent the abuse of BOC bottleneck market power.[248] As Chairman Powell has noted, "deregulation for its own sake is not responsible policy."[249]

VI. INDEPENDENT LECS SHOULD REMAIN SUBJECT TO EXISTING SAFEGUARDS.

Although there are certainly ample bases for regulating incumbent independent LECs as dominant providers of in-region long distance services in view of their continued control of their local bottlenecks, there is a rational basis for maintaining the independent LECs' nondominant status and distinguishing them from the BOCs.

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[247] *See* Order and Notice of Proposed Rulemaking, *Comsat Corp*., 13 FCC Rcd. 14083, ¶ 153, (1998) (upholding dominant carrier tariff filing requirements for Comsat services in markets where it had market power and noting that "the public interest in maintaining dominant carrier regulation in these circumstances outweighs the burdens that Comsat might experience by complying with our dominant carrier regulations in these markets").

[248] Second Order on Reconsideration and Memorandum Opinion and Order, *Regulatory Treatment of LEC Provision of Interexchange services originating in the LEC's Local Exchange Area*, 14 FCC Rcd. 10771, ¶ 37, (1999) (*LEC In-Region Interexchange Order")* ("we believe that dominant carrier regulation should be imposed only where the regulatory benefits outweigh the burdens"). *See also*, Selwyn Dec., ¶ 113 ("it is inconceivable, in light of the BOCs' extraordinary success in ramping up their long distance operations, that the BOCs can legitimately claim that dominant carrier treatment would place them at a competitive disadvantage relative to their non-dominant rivals").

[249] *See* Remarks by Michael K. Powell, Chairman, FCC, to Federal Communications Bar Association (June 21, 2001).

First, and most importantly, independent LECs are geographically dispersed with relatively small service areas and customer bases. Thus, as the D.C. Circuit explained in rejecting the BOCs' claim that section 271 was an unlawful bill of attainder because Congress subjected the BOCs to stricter regulation than the independent LECs, independent LECs simply do not have the same ability to harm long distance competition as the BOCs. Independent LECs originate relatively few calls and almost all independent LECs' customers' long distance calls will terminate on another carrier's network, which greatly reduces the ability of any independent LEC to cost-price squeeze large regional and national long distance carriers.[250]

Moreover, some independent LECs do not even provide long distance services and therefore have no incentive to impede long distance competition. Finally, given their relatively weak brands and marketing presence, independent LECs that attempt to discriminate against rivals are much less likely than the BOCs to gain customers as a result of discrimination.

At the same time, the independent LECs must comply with separate affiliate requirements that, unlike section 272, are not subject to sunset. Specifically, independent LECs are required to provide in-region, interstate interexchange services through a separate legal entity that (i) has separate books of account, (ii) has no joint ownership of switching and transmission facilities with any affiliated local exchange company, and (iii) acquires any services from any affiliated local exchange company at tariffed rates, terms and conditions or on the same basis as requesting carriers that have negotiated interconnection agreements under section 251.[251]

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[250] *BellSouth Corp. v. FCC*, 162 F.3d 678, 689 (D.C. Cir. 1998) ("[B]ecause the BOCs' facilities are generally less dispersed than [those of other competitors], they can exercise bottleneck control over both ends of a telephone call in a higher fraction of cases than can [other competitors])."

[251] *LEC Classification Order*, ¶162. The Commission subsequently modified these requirements to allow independent LECs providing in-region long-distance services solely on a resale basis, (continued . . .)

Although these separation requirements are less extensive than the structural separation requirements of section 272 -- and are patently insufficient to constrain the BOCs' market power -- the Commission could rationally determine that they remain appropriate to address the independent LECs' very different incentives and abilities. Those separation requirements will be necessary until the Commission carries out the reforms described above to remove the incumbents' access cost advantage and limit their ability to engage in non-price discrimination.

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with no use of their own switching or transmission facilities, to provide these services through a separate corporate division rather than a separate affiliate. *See LEC In-Region Interexchange Order*, ¶ 22.

CONCLUSION

For the reasons described above, the Commission should regulate BOC in-region interexchange services as dominant after sunset of the Commission's section 272 safeguards in a state until the Commission completes all of the following essential reforms to prevent BOC abuse of their local bottlenecks by removing the BOCs' access cost advantage, reducing BOC special access rates to just and reasonable levels, and establishing and enforcing performance measures preventing non-price discrimination. Independent LECs should remain subject to existing separation requirements.

Respectfully submitted,

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